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# Constitutional Federalism, Individual Liberty, and the Securities Litigation Uniform Standards Act of 1998

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# CONSTITUTIONAL FEDERALISM, INDIVIDUAL LIBERTY, AND THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

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Constitutional federalism has been called back from its deathbed by the United States Supreme Court. After half a century of deference to the growth of federal power at the expense of the states, the last decade has seen a reversal. In a series of cases beginning in 1991, the Supreme Court has consistently rebuffed Congress's attempts to interfere with state sovereignty.<sup>1</sup> Federalism once again matters to the Supreme Court.<sup>2</sup>

For a time, it appeared that the Court's efforts to protect federalism reflected a broader political current favoring government decentralization. When the Republican Party took control of Congress in 1994, there was talk of returning authority to the states and relieving the burdens that the federal government had imposed on them.<sup>3</sup> Congress even passed the Unfunded Mandates Act, erecting certain procedural obstacles to federal legislation

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1. See *Alden v. Maine*, 527 U.S. 706 (1999); *College Sav. Bank v. Florida Prepaid Postsecondary Educ. Exp. Bd.*, 527 U.S. 666 (1999); *Florida Prepaid Postsecondary Educ. Expense Bd. v. College Sav. Bank*, 527 U.S. 627 (1999); *Printz v. United States*, 521 U.S. 898 (1997); *United States v. Lopez*, 514 U.S. 549 (1995); *New York v. United States*, 505 U.S. 144 (1992); *Gregory v. Ashcroft*, 501 U.S. 452 (1991). These cases are discussed below, at *infra* notes 78-173 and accompanying text.

2. See Steven G. Calabresi, *Textualism and the Countermajoritarian Difficulty*, 66 GEO. WASH. L. REV. 1373, 1379 (1998) ("Today, judicial protection of constitutional federalism is more secure than it has been at any time since the New Deal, although the Court majority committed to constitutional federalism remains a very narrow one.").

3. See Vicki C. Jackson, *Federalism and the Uses and Limits of Law: Printz and Principle?*, 111 HARV. L. REV. 2180, 2238 (1998) ("[T]he 1994 elections appeared to give a mandate to the Republican Contract with America and its promises to return power to the states"); Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 3 (1998) ("Ironically, the Congress that now preempts these state [securities fraud] remedies has been committed to federalism in almost every other area of legislation.").

seeking to impose obligations on state governments without providing funding to help satisfy those obligations.<sup>4</sup> This commitment to federalism waned, however, when policy initiatives—that promised substantial campaign contributions from firms that would benefit from the legislation—required abridgment of state authority.<sup>5</sup> Proposals to preempt state products liability law, tobacco lawsuits, and other areas were bandied about by Congress. One proposed bill would have allowed the removal of all class actions to federal court by any defendant or non-representative plaintiff whenever one member of the plaintiff class was a citizen of a different state than any defendant.<sup>6</sup> State substantive law would still be applied, but would be subject to federal procedural rules. While these proposals have garnered a steady stream of campaign revenue for members of Congress, they ultimately have failed, hindered by the lobbying clout of the plaintiffs' bar.<sup>7</sup>

One initiative, however, has managed to survive the attorneys' gauntlet. The Securities Litigation Uniform Standards Act ("Uniform Act") was enacted by Congress in 1998.<sup>8</sup> The Uniform Act preempts securities fraud

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4. Unfunded Mandates Reform Act of 1995, Pub. L. No. 104-4, 109 Stat. 48 (codified as amended in scattered sections of 2 U.S.C.). For a discussion of the Unfunded Mandates Reform Act, see Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 U. KAN. L. REV. 1113 (1997). For a more general discussion of the subject of unfunded mandates, see Robert W. Adler, *Unfunded Mandates and Fiscal Federalism: A Critique*, 50 VAND. L. REV. 1137 (1997); Edward A. Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest and Public Services*, 46 VAND. L. REV. 1355 (1993).

5. This was a rather predictable response. See Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265 (1990).

Conservatives and liberals alike extol the virtues of state autonomy whenever deference to the states happens to serve their political needs at a particular moment. Yet both groups are also quick to wield the power of the supremacy clause, while citing vague platitudes about the need for uniformity among the states, whenever a single national rule in a particular area furthers their political interests.

See *id.* at 265. See also U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL STATUTORY PREEMPTION OF STATE AND LOCAL AUTHORITY: HISTORY, INVENTORY, AND ISSUES 38 (1992) ("As business has come to recognize the political inevitability of regulation, and as states (and many local governments) have become more energetic regulators in the face of consumer pressure, business has increasingly sought federal preemption of state and local powers."); Cheryl Bolen, *McIntosh Federalism Legislation On Hold Until Organizations Can Meet*, 31 Sec. Reg. & L. Rep. (BNA) 1300 (Oct. 1, 1999) (reporting opposition of U.S. Chamber of Commerce to proposed legislation creating presumption against preemption).

6. H.R. 3789, 105th Cong. (1998).

7. See *The Lawyers' Party*, WALL ST. J., Oct. 5, 1999, at A26 (criticizing influence of trial lawyers over Democratic Party politics). For critiques of efforts to reduce state regulation through federal preemption, see Betsy J. Grey, *Make Congress Speak Clearly: Federal Preemption of State Tort Remedies*, 77 B.U. L. REV. 559 (1997); Nim Razook, *The Perils of Pragmatic Preemption: A Caution About Using Efficiency Norms in Federal Preemption Decisions*, 15 J.L. & POL. 37 (1999).

8. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227.

class actions based on state law for certain nationally-traded securities. Congress adopted the Uniform Act in response to the tactic of using state court class actions to evade the obstacles to federal securities class actions erected by Congress in the Private Securities Litigation Reform Act of 1995 ("Reform Act").<sup>9</sup> Congress, motivated by a concerted lobbying effort from the high tech industry,<sup>10</sup> was concerned that the migration of securities class actions to state court could lead to a non-uniform, and likely lower, standard for proving securities fraud.

Congress did not, however, use the Uniform Act to preempt the substantive law of state securities fraud or its remedies. Instead, it preempted a certain procedure employed by state courts in adjudicating securities fraud cases, namely, class actions. In targeting only securities fraud class actions, Congress left state law to provide a cause of action for securities fraud, albeit one that can only be pursued individually.

This peculiar form of selective preemption gives rise to the constitutional question addressed by this Article. Congress clearly has the power to preempt all state fraud law as it applies to nationally-traded securities, as the existence of national trading markets provides a sufficient nexus to interstate commerce.<sup>11</sup> And Congress has the authority to preempt all, not just

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9. See H.R. REP. NO. 105-803, at 13 (Oct. 9, 1998) ("The purpose of this title is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court."). The Reform Act is the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.). The Reform Act made it more difficult to successfully allege securities fraud by: (1) adopting a more stringent pleading standard, including heightened requirements for pleading scienter, i.e., state of mind; and (2) creating an automatic stay of discovery. See generally Richard H. Walker et al., *The New Securities Class Action: Federal Obstacles, State Detours*, 39 ARIZ. L. REV. 641 (1997).

10. See Painter, *supra* note 3, at 4-5 ("[T]he high technology companies of Silicon Valley, one of the largest defendant groups in securities fraud class actions, made substantial political contributions and lobbied for preemption.").

11. See, e.g., *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 261-62 (1964) (holding that courts must defer to a congressional finding that a regulated activity affects interstate commerce, if the finding has any rational basis). Professor Manning Warren claims that the Uniform Act exceeds Congress's Commerce Clause power because

"fraud-related remedies granted by the states and asserted by investors are by their nature activated after the fact of the commercial transactions giving rise to their assertion. While these remedies may have incidental regulatory effects, they do not regulate commerce but, rather, accomplish the entirely separate function of compensating the victims of fraud."

Manning Gilbert Warren III, *Federalism and Investor Protection: Constitutional Restraints on Preemption of State Remedies for Securities Fraud*, 60 LAW & CONTEMP. PROBS. 169, 198 (1997). There is no basis in the Court's Commerce Clause jurisprudence, nor any economic theory, for the temporal distinction that Warren claims between securities transactions and lawsuits arising out of those transactions. It should be obvious to even the casual observer that the threat of potential state litigation is likely to have an effect on the ex ante expectations of participants in the interstate securities markets. The cumulative effect of the threat of litigation plainly authorizes Congress's exercise of its Commerce Clause power. Warren's suggestion that state regulation not precluded by the

inconsistent, state regulation.<sup>12</sup> But Congress was reluctant to take this drastic step because of the important role that state fraud law and state courts play in resolving securities disputes between individuals. Congress sought to discourage only class actions against the corporate issuer and its affiliates, with their potential for enormous damages. The form of preemption chosen was closely matched to the perceived problem of these suits migrating to state courts.

But while Congress's solution was carefully tailored to the problem it perceived, that solution may run afoul of principles of constitutional federalism. Specifically, restricting procedures that state courts may use in administering state law causes of action raises the question of Congress's authority to dictate how the states will organize their judicial process. The longstanding "general rule, bottomed deeply in belief in the importance of state control of state judicial procedure, is that federal law takes the state courts as it finds them."<sup>13</sup> Whether this general rule has a constitutional basis is unclear, and consequently, it is uncertain whether the rule binds Congress. Moreover, there are exceptions to the rule when a state has discriminated against a federal cause of action or adopted a procedure that would defeat a federal claim. It is also unclear whether these exceptions would cover the Uniform Act, which applies only to state law claims. The Uniform Act therefore raises a novel question of constitutional law: Does Congress have the power to regulate how a state court adjudicates a state law cause of action?<sup>14</sup>

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Dormant Commerce Clause cannot be preempted by Congress exercising its Commerce Clause authority is foreclosed for similar reasons. See Warren, *supra* at 199-200.

12. *Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc.*, 452 U.S. 264, 290 (1981).

13. Henry M. Hart, Jr., *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 508 (1954), *cited with approval in* *Howlett v. Rose*, 496 U.S. 356, 372 (1990).

14. While novel, this question has implications for other areas of law. See, e.g., Fair Debt Collection Practices Act, 15 U.S.C. § 1692i(a) (1988) (specifying venue limitations for state law debt collection actions brought in either state or federal court). It was also proposed to preclude state courts from adjudicating class actions in connection with the proposed tobacco settlement. See generally Wendy E. Parmet, *Stealth Preemption: The Proposed Federalization of State Court Procedures*, 44 VILL. L. REV. 1, 3-6 (1999) (discussing proposals to federalize tobacco litigation). This proposal raised serious constitutional questions. See Martin H. Redish & Steven G. Sklaver, *Federal Power to Commandeer State Courts: Implications for the Theory of Judicial Federalism*, 32 IND. L. REV. 71, 108-9 (1998).

[W]ere Congress to enact a law prohibiting multi-party product liability actions in state court against tobacco manufacturers, Congress would in effect direct state courts to employ specific procedures in enforcing their own substantive tort law in their own courts. Whether one views the issue from the perspective of congressional power under Article I or from that of the Tenth Amendment protection of states' rights, it is by no means clear that Congress possesses the constitutional authority to impose such restrictions.

*Id.*

This Article proceeds in four parts. Part I provides background on the historical development of constitutional federalism, the Supreme Court's decisions in this area, and the apparent demise of constitutional limits on federal power. Part II then reviews the Court's revival of constitutional federalism over the last decade. Based on this review, I argue that the Supreme Court's current federalism doctrine can be understood as a "constrained libertarianism" that attempts to use constitutional structure as a check on government interference with individual liberty. In this model, states are respected in our constitutional system because of the counterbalance that they provide to federal power. State autonomy is valuable because it discourages excessive federal regulation.<sup>15</sup> The Court's constitutional federalism is constrained, however, by its earlier concession of a general police power to the Congress. The Court essentially abdicated its responsibility to restrain Congress's power at the time of the New Deal. That abdication severely constrains the Court's constitutional federalism today.

Part III focuses on the Court's decisions applying the principles of constitutional federalism to state courts. It compares Congress's greater authority over state courts with the limited power that Congress wields over state legislatures and executives, and explores the limits of that authority over state courts. Part IV provides background to Congress's enactment of the Uniform Act and explains why it adopted the form of preemption that it did. It then applies the constrained libertarianism theory of constitutional federalism developed in Parts II and III of this Article to the Uniform Act.

I conclude that the Uniform Act is consistent with principles of constitutional federalism because its preemption results in less, rather than more, government interference with private conduct. That this unusual form of conditional preemption eliminates a state procedure, rather than a substantive law, should make no difference in the constitutional analysis. This preemption enhances liberty because it eliminates a secondary, and potentially inconsistent, level of government regulation. Individuals are more free if they have to deal with one level of government, rather than two, in managing their affairs. Having ceded to Congress the complete authority to regulate interstate securities markets, and thereby affording Congress the additional authority to restrict state courts in this area, the Uniform Act

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15. I do not attempt to provide a normative justification for the judicial protection of liberty here. While some readers may disagree with this normative proposition, discussion of the point would make an excessively long article still longer. Those interested should see RANDY E. BARNETT, *THE STRUCTURE OF LIBERTY* (1998); RICHARD A. EPSTEIN, *PRINCIPLES FOR A FREE SOCIETY* (1998). For those who disagree with protection of liberty as a normative matter, my "constrained libertarian" interpretation may help make sense of the Court's occasionally confusing constitutional federalism jurisprudence.

enhances individual liberty because eliminating state regulation enhances individuals' choices. State regulation cannot reduce, but can only supplement, the baseline of federal regulation. Eliminating state regulation reduces the overall amount of government. Therefore, the constrained libertarianism theory supports a broad preemption power. Finally, the Conclusion offers some thoughts on Congress's preemptive power over state courts in a world where markets are increasingly operating globally, rather than nationally.

## I. CONSTITUTIONAL FEDERALISM

### A. *Origins*

Federalism owes its constitutional status in our political system more to practical politics than to political theory. When the Framers convened in Philadelphia in 1787, the states were established entities, with roots going deep into the colonial era. The national government, by contrast, could trace its roots back no further than a decade, to the convening of the first Continental Congress. Worse yet, the national government had quickly established a reputation for being ineffective under the Articles of Confederation, unable to accomplish those governmental functions that were more effectively done at the national level.<sup>16</sup> Given this background, preservation of the states' autonomy was not merely a useful political innovation, but necessary for the viability of any constitutional proposal.<sup>17</sup> Any plan that subordinated the states to mere administrative units of the federal government would have met a quick death when sent out to the states for ratification. Thus, the states retained "a residuary and inviolable sovereignty" under the new Constitution, "no more subject, within their respective spheres, to the general authority than the general authority is subject to them, within its own sphere."<sup>18</sup>

James Madison and the other authors of *The Federalist Papers*, all skilled rhetoricians, transformed this necessity into a virtue:

In the compound republic of America, the power surrendered by the people is first divided between two distinct governments, and then the

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16. See Jack N. Rakove, *The First Phases of American Federalism*, in *COMPARATIVE CONSTITUTIONAL FEDERALISM: EUROPE AND AMERICA* 1, 5-6 (Mark Tushnet, ed., 1990).

17. The Constitutional Convention explicitly rejected proposals by Hamilton and others to eliminate the states quasi-sovereign status. See John C. Yoo, *The Judicial Safeguards of Federalism*, 70 S. CAL. L. REV. 1311, 1367-1368 (1997).

18. *The Federalist* No. 39, at 245 (James Madison) (Clinton Rossiter ed., 1961)

portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself.<sup>19</sup>

This concept of “dual sovereignty”—separate and distinct spheres of national and state authority—meant that states would be vigilant monitors of attempts by the national government to expand its authority beyond those powers enumerated in the Constitution. Any addition to federal authority would imply a subtraction from state authority.<sup>20</sup> Thus, the constitutional federalism of dual sovereignty enlisted the states as guardians of individual liberty against federal encroachment. At the same time, competition among the states and constitutional limits on state power would restrict state encroachments on individual liberty.<sup>21</sup>

Hamilton argued that the states would protect liberty in another fashion. He saw the states as focal points for organizing the people’s opposition to overreaching by the national government.

Power being almost always the rival of power, the general government will at all times stand ready to check the usurpations of the state governments, and these will have the same disposition towards the general government. The people, by throwing themselves into either scale, will infallibly make it preponderate. If their rights are invaded by either, they can make use of the other as an instrument of redress.<sup>22</sup>

While Madison and Hamilton agreed that the states would help protect liberty, they foresaw different mechanisms by which the states could act. Madison’s argument assumes legal limits on the federal government’s power, perhaps enforceable in court, while Hamilton’s argument seems to rely on

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19. The Federalist No. 51, at 323 (James Madison) (Clinton Rossiter ed., 1961).

20. See H. Jefferson Powell, *The Oldest Question of Constitutional Law*, 79 VA. L. REV. 633, 654 (1993) (“Both sides to the debate were hampered by their shared assumption that ‘sovereignty’ was a unitary and exclusive quality, capable neither of division nor of joint tenancy. Sovereignty meant control, and the ‘logic of the doctrine of sovereignty required either the state legislatures or the national Congress to predominate.’”).

21. See John McGinnis, *The Boundaries of Legislative Power*, 13 J.L. & POL. 588, 589 (1997) (“[T]he federal government was restrained by the Constitution, and the states were restrained by competition that the federal government maintained through keeping open the avenues of trade and investment.”).

22. The Federalist No. 28, at 181 (Alexander Hamilton) (Clinton Rossiter ed., 1961). See also Vicki C. Jackson, *Federalism and the Uses and Limits of Law: Printz and Principle*, 111 HARV. L. REV. 2180, 2219 (1998) (“Particularly given judicially enforceable traditions of regular and free voting and of a free press, states need not threaten the use of military force in order to provide structures for development and organized expression of countervailing positions to those of the national government.”).



the political process, fueled by popular pressure. This difference was not resolved at the time,<sup>23</sup> but has played a crucial role in disputes over the role of constitutional federalism in the late Twentieth Century.

### *B. The Decline of Dual Sovereignty*

This notion of dual sovereignty prevailed for many years after the Constitution was adopted, restraining both the federal and state governments.<sup>24</sup> But the premise of the dual sovereignty argument, that state and federal authority were separate, rather than overlapping, was eventually exposed as its weakest link. Dual sovereignty began to fray as the national government sought to expand its authority in the post-Civil War era. The 13th, 14th and 15th Amendments explicitly shifted the line between state and federal authority giving Congress a variety of tools with which to protect the civil liberties of the newly-freed slaves from state encroachment.<sup>25</sup>

The more fundamental expansion of national authority was not reflected in any constitutional amendment, but was instead adversely possessed as a result of the federal government continually pushing the boundaries of its authority. Technological advances of the Nineteenth Century made it possible to organize business on a national level in many industries.<sup>26</sup> Consequently, national politicians began to see opportunities to extract rents from those industries. Beginning with the Interstate Commerce Act's cartelization of the railroad industry,<sup>27</sup> followed soon thereafter by the Sherman Act's rent extraction from technologically innovative national producers such as Standard Oil,<sup>28</sup> Congress began to look for ways to redistribute wealth generated by the increasingly national economy.

At the same time, states looked to create or protect rents by protecting local producers from out-of-state competitors. The field of securities laws

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23. See Yoo, *supra* note 17, at 1381-91 (providing history of debate over protections of state sovereignty).

24. See Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485, 1491 (1994) ("There was, in fact, a time when the Supreme Court flirted with the idea of establishing absolute, mutually exclusive domains for the state and federal governments.").

25. See Jenna Bednar & William N. Eskridge, Jr., *Steadying the Court's "Unsteady Path": A Theory of Judicial Enforcement of Federalism*, 68 S. CAL. L. REV. 1447, 1464 (1995) ("Whatever viability the Framers' libertarian theory had for federalism originally, it has been overtaken by the rights-based libertarian approach followed since the Civil War.").

26. See Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 369 (1997) ("Rapid advances in communications, transportation, and industrialization brought us together as a nation and forced reconsideration of the rules by which we governed ourselves.").

27. See George W. Hilton, *The Consistency of the Interstate Commerce Act*, 9 J.L. & ECON. 87, 87-99 (1966).

28. *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

provides an apt example. Beginning in the early part of the Twentieth Century, states adopted "blue sky" laws imposing disclosure and other regulatory hurdles on businesses seeking capital from investors in those states.<sup>29</sup> These barriers to entry protected well-organized local consumers of capital, primarily local banks and farmers, from competition, thus keeping their price of capital low.<sup>30</sup>

Both rent creation and rent extraction require the power to regulate. Rent creation requires regulation to exclude competitors, while rent extraction requires a credible threat of regulation.<sup>31</sup> These conflicting demands for regulatory authority soon led to conflict between state and federal power.<sup>32</sup> The line between state and national authority was being pushed from both directions, and the Supreme Court struggled with the effort to draw it. Even in the face of the national economic crisis of the Great Depression, the Court endeavored to maintain a strict separation between the spheres of state and national power.<sup>33</sup> Franklin Roosevelt's threat to the Court's independence, however, forced the Court to fold, eventually abandoning its efforts to limit Congress's power to regulate interstate commerce.<sup>34</sup> Indeed, the Court construed the Commerce Clause, in conjunction with the Necessary and Proper Clause, so broadly that Congress was allowed to regulate conduct that

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29. Kansas adopted the first blue sky law in 1911. See THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 367 (2d ed. 1990).

30. Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 351 (1991) ("State banking regulators, interested in protecting and expanding their regulatory turf and in advancing the financial interests of banks under their supervision . . . [as well as] farmers and small business owners who saw the suppression of securities sales as a useful means for increasing their own access to bank credit.").

31. See Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 *passim* (1987).

32. See Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1488 (1987) ("Constitutional limits expressed in terms of interstate consequences lead to different results when applied to railroads than when applied to a horse and buggy. As the size of the market has expanded, so has federal power.").

33. See *United States v. Constantine*, 296 U.S. 287, 296 (1935) (rejecting attempt by "the United States [to] impose cumulative penalties above and beyond those specified by State law for infractions of State's criminal code by its own citizens. . . . The concession of such a power would open the door to unlimited regulation of matters of state concern by federal authority."); *Hopkins Fed. Sav. & Loan Ass'n v. Cleary*, 296 U.S. 315, 338 (1935) (setting aside, as an "illegitimate encroachment by the government of the nation upon a domain of activity set apart by the Constitution as the province of the states," federal law allowing state-chartered S&L's to switch to a federal charter).

34. See McNollgast, *Politics and the Courts: A Positive Theory of Judicial Doctrine and the Rule of Law*, 68 S. CAL. L. REV. 1631, 1670-71 (1995) (arguing that the Court initially resisted the New Deal in hopes of generating a political backlash, only to back down when it became clear that the New Deal had strong support within Congress and the electorate); *but see* Barry Cushman, *Rethinking the New Deal Court*, 80 VA. L. REV. 201 *passim* (1994) (arguing that the judicial loosening of restrictions on Congress's power was more gradual than is typically thought).

was neither commerce *nor* interstate.<sup>35</sup> By cumulating individual instances of regulated activity, Congress was effectively given the equivalent of a general police power.<sup>36</sup> State sovereignty placed no limit on that power.<sup>37</sup> Distinct spheres of allocated power could no longer serve as the basis for the conclusion that the federal government could not interfere with state authority.

### C. *The Era of Congressional Dominance*

Despite the predictions of Madison and Hamilton, the states did not rise up to protest the New Deal power grab by the federal government. Two factors contributed to silence the states. First, the states' voice in federal government largely had been eliminated by the Seventeenth Amendment, which transferred the power to choose Senators from state legislatures to state voters.<sup>38</sup> The result was to make Senators answer primarily to national, rather than local, interest groups.<sup>39</sup> The second factor was the Court's concession to state level rent seeking. At the same time that the Court was sanctioning Congress's assumption of a general police power, it was freeing the states' hands to extract rents from business and industry.<sup>40</sup> Only a generation before, the Court had rejected state attempts to cartelize industry as inconsistent with the freedom of contract guaranteed by the Due Process

35. See *Wickard v. Filburn*, 317 U.S. 111, 127-29 (1942) (upholding federal regulation of wheat grown for home consumption). See also Stephen Gardbaum, *Rethinking Constitutional Federalism*, 74 TEX. L. REV. 795, 807-11 (1996) (discussing the role of the Necessary and Proper Clause in the expansion of federal power).

36. See *Perez v. United States*, 402 U.S. 146, 154 (1971) ("Where the *class of activities* is regulated and that *class* is within the reach of federal power, the courts have no power 'to excise, as trivial, individual instances' of the class.").

37. See, e.g., *United States v. Darby*, 312 U.S. 100, 124 (1941) (the Tenth Amendment's reservation of power to the states reflects "but a truism that all is retained which has not been surrendered.").

38. U.S. CONST. amend. XVII.

39. See Todd J. Zywicki, *Senators and Special Interests: A Public Choice Analysis of the Seventeenth Amendment*, 73 OR. L. REV. 1007, 1039-41 (1994). See also *Garcia v. San Antonio Metro Transit. Auth.*, 469 U.S. 528, 565 n.9 (1985) (Powell, J., dissenting) (arguing that members of Congress answer to national, rather than state, constituencies); Calabresi, *supra* note 2, at 1389

Senators no longer represent the states as institutions; they represent popular majorities in each State and national factions that give senators money to advertise on television in their respective states. Many small state senators from both political parties raise most of their campaign funds from out of state. These senators thus are often more beholden to national corporate and labor political action committees than they are to the voters who nominally elect them.

*Id.*

40. See Stephen Gardbaum, *New Deal Constitutionalism and the Unshackling of the States*, 64 U. CHI. L. REV. 483, 506-32 (1997).

Clause.<sup>41</sup> The New Deal Court, however, abandoned the effort to protect individuals from wealth redistribution by the states.<sup>42</sup> That Court also tolerated states' efforts to regulate what earlier Courts had held to be interstate commerce, and thus, the province of the federal government.<sup>43</sup> Finally, the New Deal Court overruled *Swift v. Tyson*,<sup>44</sup> thereby making state supreme courts the final arbiters of state common law.<sup>45</sup> This freed state supreme courts to use the common law as a tool of social policy. Thus, the states were given a far greater domain in which to seek rents, at both the legislative and judicial level, to compensate for occasional federal incursions into what had previously been the states' exclusive territory.

The expansion of national power inevitably led to a narrowing of residual state subject matter authority, and the Court consistently sided with the national government over the states.<sup>46</sup> The Court soon abandoned any real pretense of constraining Congress's spending power,<sup>47</sup> and left Congress free to attach conditions to funds that states receive when administering a federal program.<sup>48</sup> The Court also gave Congress broad authority to preempt state law, stating that "any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause."<sup>49</sup> These twin

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41. See *Lochner v. New York*, 198 U.S. 45 (1905).

42. See *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937).

43. See Lawrence Lessig, *Translating Federalism: United States v. Lopez*, 1995 SUP. CT. REV. 125, 167-68 (discussing the narrowed scope of preemption brought on by the New Deal Court).

44. 41 U.S. (16 Pet.) 1 (1842).

45. See *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). "Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts." *Id.* at 78.

46. In the few cases that arose before this time the states received a more sympathetic hearing. See *Coyle v. Smith*, 221 U.S. 559, 579 (1911) (holding that Congress could not dictate the location of Oklahoma's state capital after it had been admitted as a state).

47. See *South Dakota v. Dole*, 483 U.S. 203, 207 (1987) ("[O]bjectives not thought to be within Article I's 'enumerated legislative fields', may nevertheless be attained through the use of the spending power and the conditional grant of federal funds."); Lessig, *supra* note 43, at 188-190 (arguing that the Court's rules on Congressional spending impose no constraint at all).

48. See *Bell v. New Jersey*, 461 U.S. 773, 790 (1983) ("Requiring States to honor the obligations voluntarily assumed as a condition of federal funding before recognizing their ownership of funds simply does not intrude on their sovereignty."). While Congress is free to impose conditions on federal spending, the states are free to refuse the money if the conditions are too onerous. The result is bargaining between state and federal officials over the terms of the grant. See Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, 96 MICH. L. REV. 813, 861-65 (1998) (discussing the constitutionality of conditions on federal grants). On the subject of congressionally placed conditions on the receipt of federal funds, see generally Lynn A. Baker, *Conditional Federal Spending After Lopez*, 95 COLUM. L. REV. 1911 (1995); Thomas R. McCoy & Barry Friedman, *Conditional Spending: Federalism's Trojan Horse*, 1988 SUP. CT. REV. 85.

49. *Perez v. Campbell*, 402 U.S. 637, 652 (1971). The development of the Court's preemption doctrine is discussed in Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767,

powers of preemption and conditional spending give Congress tremendous leverage over state regulatory authority.<sup>50</sup>

Other aspects of state sovereignty were brought under Congress's discretion in the post-New Deal era. When New York State went into the business of selling bottled water, the Court found no impediment to Congress's imposing an excise tax on the water, as long as it imposed the same tax on water sold by private parties.<sup>51</sup> Thus, while New York was protected from being singled out by the federal government, it could not assert immunity from taxation based solely on its status as an independent sovereign.<sup>52</sup>

### *D. The Death of Constitutional Federalism?*

A series of cases from the 1980s appeared to signal the ultimate demise of federalism limits on Congress's power. The first is *Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc.*<sup>53</sup> The Surface Mining Control and Reclamation Act of 1977 ("Reclamation Act") established national policy for the control of the environmental effects of strip mining.<sup>54</sup> Under the Reclamation Act, "any State wishing to assume permanent regulatory authority over the surface coal mining operations . . . within its borders must submit a proposed permanent program to the Secretary [of the Interior]."<sup>55</sup> The Secretary was to approve the program only if the state legislature had enacted laws reflecting congressionally adopted environmental standards. If the state failed to submit a program, the Secretary was directed to develop a

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785-807 (1994).

50. The federal courts also have substantial power over the states, as it is a "settled principle that federal courts may enjoin unconstitutional action by state officials." *Puerto Rico v. Branstad*, 483 U.S. 219, 228 (1987). As states can only act through their agents, this is a substantial constraint on state regulation.

51. See *New York v. United States*, 326 U.S. 572, 582 (1946) ("[S]o long as Congress generally taps a source of revenue by whomsoever earned and not uniquely capable of being earned only by a State, the Constitution of the United States does not forbid it merely because its incidence falls also on a State.").

52. See *South Carolina v. Baker*, 485 U.S. 505, 525 (1988) (upholding non-discriminatory tax imposed on income from bonds issued by state, concluding that: "States have no constitutional entitlement to issue bonds paying lower interest rates than other issuers."). This rule applies even if the tax applies to "traditional" governmental functions. See also *Massachusetts v. United States*, 435 U.S. 444 (1978) (upholding application of a general tax on a civil aircraft to helicopters used by state police).

53. 452 U.S. 264 (1981).

54. See Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. §§ 1201-1328 (1994 & Supp. III 1997).

55. *Hodel*, 452 U.S. at 271.

permanent federal regulatory program for that state.<sup>56</sup> Thus, states were allowed to regulate in the area only if the state legislature enacted federal policy as state law.

Virginia challenged this aspect of the Reclamation Act as violating the Tenth Amendment. The Court rejected the claim, stating that:

[T]he states are not compelled to enforce the . . . standards, to expend any state funds, or to participate in the federal regulatory program in any manner whatsoever. If a State does not wish to submit a proposed permanent program that complies with the Act and implementing regulations, the full regulatory burden will be borne by the Federal Government. Thus, there can be no suggestion that the Act commandeers the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.<sup>57</sup>

As long as Congress did not *require* the states to regulate, the Court saw no difficulty with Congress dictating how the states regulated, if the states chose to do so. Given that Congress had the greater power to preempt state regulation altogether, no constitutional problem arose when it exercised the lesser power to specify the mode of state regulation.<sup>58</sup> States would regulate according to the federal standards only if they had an independent policy interest in doing so. Otherwise, regulation would be a federal responsibility.

Congress's power to control state regulation of private parties was confirmed emphatically the following term in *FERC v. Mississippi*.<sup>59</sup> The Public Utility Regulatory Policies Act of 1978 ("PURPA")<sup>60</sup> required state regulators to "consider" the adoption and implementation of specific 'rate design' and regulatory standards;" follow certain notice and comment procedures in considering the proposed federal standards; and resolve disputes among regulated parties arising out of the implementation of those standards.<sup>61</sup> Mississippi challenged the law as exceeding Congress's Commerce Clause power and violating the Tenth Amendment.<sup>62</sup> The Court quickly dismissed Mississippi's argument that the state's "governance of commerce"<sup>63</sup> was beyond the reach of the Commerce Clause. The state's

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56. See *id.* at 272.

57. *Id.* at 288.

58. See *id.* at 290.

59. 456 U.S. 742 (1982).

60. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified as amended in scattered sections of 16 U.S.C.).

61. 456 U.S. at 746-48.

62. See *id.* at 752.

63. *Id.* at 755.

claim was undercut by Congress's finding that the use of electric power affected interstate commerce, and the Court found that this finding was not irrational.<sup>64</sup> The Court's long-standing deference to federal power determined this outcome.

The Tenth Amendment challenge required more substantial discussion. The Court described Congress's "attempts to use state regulatory machinery to advance federal goals" as raising "an issue of first impression."<sup>65</sup> The enlistment of state utility commissioners to resolve disputes among private parties was unobjectionable because "[d]ispute resolution of this kind is the very type of activity customarily engaged in by the Mississippi Public Service Commission."<sup>66</sup> The principle that state courts could not discriminate against federal claims was held to apply to state agencies as well, as long they were given adjudicative responsibilities under state law.<sup>67</sup> The requirement that states consider rate making standards and follow certain procedures in doing so was supported by the conditional preemption rationale that resolved *Hodel*:

[I]f a State has no utilities commission, or simply stops regulating in the field, it need not even entertain the federal proposals.

. . . Congress could have pre-empted the field, at least insofar as private rather than state activity is concerned; PURPA should not be invalid simply because, out of deference to state authority, Congress adopted a less intrusive scheme and allowed the states to continue regulating in the area on the condition that they *consider* the suggested federal standards.<sup>68</sup>

Once again, Congress was not compelling the state to regulate, only imposing certain conditions on states that chose to regulate. The Court attached no constitutional significance to the fact that Congress had made no provision for regulating the utilities if the states failed to adopt the federal standards, deeming any coercion reflected in the choice between abandoning

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64. *See id.* at 755-58.

65. *Id.* at 759.

66. *Id.* at 760.

67. *See id.* at 760-61.

That the Commission has administrative as well as judicial duties is of no significance. Any other conclusion would allow the States to disregard both the preeminent position held by federal law throughout the Nation, and the congressional determination that the federal rights granted by PURPA can appropriately be enforced through state adjudicatory machinery.

*Id.* On the principle of non-discrimination by state courts, see *infra* at notes 190-195 and accompanying text.

68. *Id.* at 764-65.

regulation altogether or following federal standards constitutionally irrelevant.<sup>69</sup> The weight of the state interest in regulating a particular area apparently did not enter into the constitutional calculus.

The culmination of a half-century of congressional dominance over the states came in *Garcia v. San Antonio Metropolitan Transit Authority*.<sup>70</sup> Overturning a decision only a decade old that had appeared to give new life to the Tenth Amendment,<sup>71</sup> the Court held that Congress was free to impose the same rules on state governments that it imposed on private actors. Given that the Court had long since abandoned any federalism limits on what Congress could constitutionally impose on private actors, this concession of power opened the door to dramatic incursions into state sovereignty. States were left to protect themselves, like individuals, through the political process.<sup>72</sup> The Court took comfort in the demonstrated ability of the states to garner their share of federal revenues and to gain exemptions from a variety of otherwise generally applicable laws.<sup>73</sup> Although the states had not obtained an exemption from the statute at issue, the burden was not onerous. The Court observed that the state agency “faces nothing more than the same minimum-wage and overtime obligations that hundreds of thousands of other employers, public as well as private, have to meet.”<sup>74</sup> Lobbying, not lawsuits, was to be the bulwark of federalism.<sup>75</sup> The dissenters fretted that the decision signaled the death of constitutional federalism and the independent sovereignty of the states.<sup>76</sup>

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69. See *id.* at 766.

70. 469 U.S. 528 (1985).

71. See *National League of Cities v. Usery*, 426 U.S. 833 (1976).

72. See *Garcia*, 469 U.S. at 552. “State sovereign interests . . . are more properly protected by the procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power.” *Id.*

73. See *id.* at 552-54.

74. *Id.* at 554.

75. See *id.* at 556 (“[T]he principal and basic limit on the federal commerce power is that inherent in all congressional action—the built-in restraints that our system provides through state participation in federal governmental action. The political process ensures that laws that unduly burden the States will not be promulgated.”).

76. See *id.* at 579 (Powell, J., dissenting) (“Although the Court’s opinion purports to recognize that the States retain some sovereign power, it does not identify even a single aspect of state authority that would remain when the Commerce Clause is invoked to justify federal regulation.”); *Id.* at 588 (O’Connor, J., dissenting) (“If state autonomy is ignored in assessing the means by which Congress regulates matters affecting commerce, then federalism becomes irrelevant simply because the set of activities remaining beyond the reach of such a commerce power ‘may well be negligible.’”). Commentators have agreed. See, e.g., William W. Van Alstyne, *The Second Death of Federalism*, 83 MICH. L. REV. 1709 (1985).



## II. FEDERALISM REVIVED

Despite the seeming death knell sounded in *Garcia*, the 1990s have seen a revival of the judiciary's role in policing congressional incursions into the sovereignty of the states. Two features of the Court's decisions reviving constitutional federalism—one normative, the second doctrinal—are noteworthy. First, the decisions repeatedly invoke liberty as the goal of constitutional federalism. The Court's explanations, however, tend to revolve around accountability, which has only a tenuous connection to liberty. The second feature of the Court's constitutional federalism decisions is that they go to great lengths to establish their consistency with earlier doctrine. This respect for *stare decisis* creates a tension in the Court's doctrine, as it continues to insist that dual sovereignty puts limits on the power of the federal government, but nonetheless defers to Congress's power over individuals.

Notwithstanding the Court's deference to Congress, the Court's constitutional federalism decisions do help to enlist the states in preserving liberty against overreaching by the federal government. Those decisions fall into four categories: (1) limits on Congress's power; (2) the clear statement rule; (3) commandeering; and (4) sovereign immunity. The last three categories do not limit the federal government's power directly, but instead limit indirectly by giving the states clear incentives and the means to resist attempts to expand federal power. Thus they combine Madison and Hamilton's vision of the role of the states in preserving liberty.<sup>77</sup>

### A. Normative and Doctrinal Justification

#### 1. Constitutional Federalism and Individual Liberty

The Court's efforts to explain the relationship between constitutional federalism and individual liberty have been somewhat vague.<sup>78</sup> For example, Justice Kennedy, in his concurring opinion in *United States v. Lopez*, argued the following:

Though on the surface the idea may seem counterintuitive, it was the insight of the Framers that freedom was enhanced by the creation of two governments, not one. . . .

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77. For a discussion of Madison and Hamilton's vision, see *supra* notes 19-23 and accompanying text.

78. See Friedman, *supra* note 26, at 319 ("The values of federalism are invoked regularly in much the same way as 'Mom' and 'apple pie': warm images with little content.").

The theory that two governments accord more liberty than one requires for its realization two distinct and discernable lines of political accountability: one between the citizens and the Federal Government; the second between the citizens and the States. If, as Madison expected, the [f]ederal and [s]tate [g]overnments are to control each other, and hold each other in check by competing for the affections of the people, those citizens must have some means of knowing which of the two governments to hold accountable for the failure to perform a given function. . . . Were the Federal Government to take over the regulation of entire areas of traditional state concern, areas having nothing to do with the regulation of commercial activities, the boundaries between the spheres of federal and state authority would blur and political responsibility would become illusory. The resultant inability to hold either branch of the government answerable to the citizens is more dangerous even than devolving too much authority to the remote central power.<sup>79</sup>

So, while Justice Kennedy claims liberty as his ultimate normative justification for constitutional federalism, his argument is couched much more in terms of accountability. Justice Kennedy leaves it unclear how accountability, absent meaningful limits on federal power, will preserve freedom. In particular, he does not explain how accountability to the *electorate* can be translated into freedom for *individuals*. Kennedy suggests that clear lines of authority will encourage the electorate to sanction the federal government for overreaching. But the point is hardly self-evident; perhaps greater accountability to the voters will lead to more government regulation, rather than less, as politicians redouble their efforts to pander to interest groups. Democracy may be compatible with individual liberty, but the concepts are far from equivalent.<sup>80</sup> If the protection of liberty is the goal, the political process seems a poor substitute for the right of an individual or a State to seek a federal court order enjoining a power grab by the federal government.<sup>81</sup>

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79. See *Lopez*, 514 U.S. at 576-77 (citations omitted).

80. For a thoughtful discussion of the relationship between the two, see Rebecca L. Brown, *Accountability, Liberty, and the Constitution*, 98 COLUM. L. REV. 531, 571-78 (1998).

81. Kennedy again invoked accountability in a later case protecting state sovereign immunity: "[I]f the principle of representative government is to be preserved to the States, the balance between competing interests must be reached after deliberation by the political process established by the citizens of the State, not by judicial decree mandated by the Federal Government and invoked by the private citizen." See *Alden v. Maine*, 527 U.S. 706 (1999). Political accountability was in turn justified by the court as "essential to our liberty and republican form of government." *Id.* As in his prior effort, however, Kennedy did not further elaborate on the supposed connection.

Justice O'Connor, perhaps the Court's staunchest defender of federalism, has also invoked liberty as the goal of constitutional federalism, but like Justice Kennedy, her account relies much more heavily on accountability. In *Gregory v. Ashcroft*,<sup>82</sup> Justice O'Connor was realistic about the limits that the Court could place on congressional aggrandizement:

One fairly can dispute whether our federalist system has been quite as successful in checking government abuse as Hamilton promised, but there is no doubt about the design. . . . [T]o be effective, there must be a proper balance between the States and the Federal Government. These twin powers will act as mutual restraints only if both are credible. In the tension between federal and state power lies the promise of liberty.

The Federal Government holds a decided advantage in this delicate balance: the Supremacy Clause. As long as it is acting within the powers granted it under the Constitution, Congress may impose its will on the States. Congress may legislate in areas traditionally regulated by the States. This is an extraordinary power in a federalist system.<sup>83</sup>

Despite the difficulties in placing limits on federal power, O'Connor argued that dual sovereignty offered a number of advantages: (1) "a decentralized government that will be more sensitive to the diverse needs of a heterogenous society;" (2) "opportunity for citizen involvement in democratic processes;" (3) "more innovation and experimentation in government;" and (4) "it makes government more responsive by putting the States in competition for a mobile citizenry."<sup>84</sup> The first three purposes, while perhaps normatively justifiable in their own right, turn on accountability, not liberty, as they go to government's accuracy in registering citizen preferences and efficiency in translating those preferences into policy. Only the last of these purposes potentially serves the cause of individual liberty. Citizens of states with overreaching governments (e.g., Massachusetts) will flee to more laissez-faire regimes (e.g., New Hampshire). But this purpose protects

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82. 501 U.S. 452 (1991).

83. *Gregory*, 501 U.S. at 459-60 (citation omitted). The Court's realism about its ability to restrain Congress is reflected in an earlier concurrence by Justice Rehnquist:

It is illuminating for purposes of reflection, if not for argument, to note that one of the greatest 'fictions' of our federal system is that the Congress exercises only those powers delegated to it, while the remainder are reserved to the States or to the people. . . . [O]ne could easily get the sense from this Court's opinions that the federal system exists only at the sufferance of Congress.

*Hodel*, 452 U.S. at 307 (Rehnquist, J., concurring).

84. *Gregory*, 501 U.S. at 458.

individuals only from state interference, not federal.<sup>85</sup>

Encouraging competition among the states stands in considerable tension with the Court's previous identification of the prevention of "destructive interstate competition" as "a traditional role for congressional action under the Commerce Clause."<sup>86</sup> When Congress regulates, it eliminates (or at least reduces) state competition, whether that competition advanced or diminished individual liberty. The Court makes no effort to distinguish which of the two effects dominates, but instead defers to congressional power.<sup>87</sup> And that power has been invoked more frequently to reduce the range of individual choice.<sup>88</sup> Given the acceptance by both Kennedy and O'Connor of this broad

85. See Jonathan Rodden & Susan Rose-Ackerman, *Does Federalism Preserve Markets?* 83 VA. L. REV. 1521, 1558 (1997) ("Competitive subnational governments without a strong central government have little incentive to engage in redistribution to the poor."). Thus, efforts at redistribution will be channeled toward the federal level. See Kramer, *supra* note 24, at 1549-50.

[T]he ability to limit immigration, coupled with the power to regulate the economy, makes it easier for Congress to take equity into account alongside efficiency. As a result, political pressures for redistribution tend to get channeled to the national level—a movement seen today in areas like taxation, welfare benefits, health, and even education.

*Id.* There is room for doubt, however, whether these redistributions will be from the rich to the poor. See DAVID L. SHAPIRO, *FEDERALISM: A DIALOGUE* 79 (1995). [T]he ability to achieve "redistribution of the nation's wealth"—one widely heralded advantage of national over state authority—is more likely than not to take the form of redistribution from the less organized to the more concentrated, better financed, more cohesive groups. The history of national subsidies in a wide range of situations supports the validity of this view. *Id.* The effect of that competition among the states is disputed. Compare Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race To Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1173-74 (1999) (arguing that competition among states for corporate charters encourages laxity in regulation); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1435 (1992) (arguing that "state competition is likely to fail with respect to certain important issues that state corporate law has traditionally governed") with Robert Daines, *Does Delaware Law Improve Firm Value?* (1999) (unpublished manuscript) (finding empirical evidence that Delaware law adds value); Mary E. Kostel, Note, *A Public Choice: Perspective on the Debate over Federal Versus State Corporate Law*, 79 VA. L. REV. 2129, 2130 (1993) (arguing that "interest groups are as likely to skew legislation toward management interests—and away from shareholder's interests—at the federal level as at the state level").

86. *Hodel*, 452 U.S. at 282.

87. See e.g., *South Carolina v. Baker*, 485 U.S. 505, 513 (1988) ("[N]othing in *Garcia* or the Tenth Amendment authorizes courts to second-guess the substantive basis for congressional legislation.").

88. See Andrzej Rapaczynski, *From Sovereignty to Process: The Jurisprudence of Federalism After Garcia*, 1985 SUP. CT. REV. 341, 410-11 (discussing federal government's advantage in facilitating wealth transfers). For this reason, states may in fact prefer to have their discretion eliminated by uniform federal policies. See Evan H. Caminker, *State Sovereignty and Subordinancy: May Congress Commandeer State Officers To Implement Federal Law?*, 95 COLUM. L. REV. 1001, 1012 (1995).

[D]ecentralized decisionmaking may even lead a state to eschew policies that it truly desires for fear that they will influence a mobile citizenry and commercial-industrial base to react in ways that undermine local welfare. A state might decide not to adopt regulatory standards that entail substantial costs for industry and obstacles to economic development out of concern that the

federal power, we can question whether their invocation of liberty as the goal of constitutional federalism is genuine, or simply a rhetorical flourish meant to make accountability seem more attractive.

Justice O'Connor's focus seems to be limiting *abuse* of power, rather than limiting power per se. She identified "the principal benefit of the federalist system" as "a check on abuses of government power."<sup>89</sup> She analogized to the separation of powers at the federal level, relying upon *The Federalist* as her authority for the proposition that the division of power preserves freedom, without specifying just how that mechanism might work.<sup>90</sup> Justice O'Connor urged this point again in *New York v. United States*<sup>91</sup> with no greater specificity.<sup>92</sup> Indeed, her vagueness on this point led the dissent to dismiss the invocation of liberty as resort "to generalities and platitudes about the purpose of federalism being to protect individual rights."<sup>93</sup>

Justice Scalia also relied on liberty as a normative justification in *Printz v. United States*.<sup>94</sup> He argued that the "separation of the two spheres is one of the Constitution's structural protections of liberty. . . . The power of the Federal Government would be augmented immeasurably if it were able to impress into its service—and at no cost to itself—the police officers of the 50 States."<sup>95</sup> Prohibiting the federal government from conscripting the states limits government because it precludes Congress from going off budget to fund its agenda. Scalia's reference to the states' police powers suggests that commandeering might also be an end-run around the Constitution's limitation of Congress to enumerated powers. Both of these concerns are consistent with a liberty-enhancing vision of constitutional federalism.

In the Court's recent sovereign immunity cases, Justice Scalia once again

welfare gains to state residents from the regulation will be more than offset by the exit of capital to other states imposing less rigorous standards.

*Id.*

89. *Gregory*, 501 U.S. at 458.

90. *See id.* at 458-59 (citing both *The Federalist* No. 28 (Hamilton) & No. 51 (Madison)). For a discussion of *The Federalist* No. 28 and No. 51, see *supra* notes 19-22 and accompanying text.

91. 505 U.S. 144 (1992).

92. *See New York*, 505 U.S. at 181.

The Constitution does not protect the sovereignty of States for the benefit of the States or state governments as abstract political entities, or even for the benefit of the public officials governing the States. To the contrary, the Constitution divides authority between federal and state governments for the protection of individuals. State sovereignty is not just an end in itself: "Rather, federalism secures to citizens the liberties that derive from the diffusion of sovereign power."

*Id.* (quoting *Coleman v. Thompson*, 501 U.S. 722, 759 (Blackmun, J., dissenting)).

93. *Id.* at 206 (White, J., concurring in part and dissenting in part).

94. 521 U.S. 898 (1997).

95. *Printz*, 521 U.S. at 921.

invoked individual liberty. He did not spare his sarcasm in taking the dissenters to task for espousing a concept of liberty—participation in democratic decision-making—unknown to the framers of the Constitution:

The proposition that “the protection of liberty” is most directly achieved by “promoting the sharing among citizens of governmental decision-making authority” might well have dropped from the lips of Robespierre, but surely not from those of Madison, Jefferson, or Hamilton, whose north star was that governmental power, even—indeed, especially—governmental power wielded by the people, *had to be dispersed and countered*. And to say that the degree of dispersal to the States, and hence the degree of check by the States, is to be governed by Congress’s need for “legislative flexibility” is to deny federalism utterly. . . . Legislative flexibility on the part of Congress will be the touchstone of federalism when the capacity to support combustion becomes the acid test of a fire extinguisher. Congressional flexibility is desirable, of course—but only within the *bounds of federal power* established by the Constitution. Beyond those bounds (the theory of our Constitution goes), it is a menace.<sup>96</sup>

Liberty, in Scalia’s view, required keeping government power within its constitutional bounds, not democratic participation in the direction of federal power.<sup>97</sup> Thus, Justice Scalia’s formulation of federalism’s liberty preserving virtues is in tension with Kennedy and O’Connor’s attempt to conflate liberty with democratic accountability. But Kennedy and O’Connor would certainly agree with Justice Scalia that it is essential for states to retain their own power if they are to serve as a “counter” to the power of the federal government. Leaving state authority to the discretion of Congress effectively means no counterweight to federal authority. And federal authority, left unchecked, is a “menace” to freedom.

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96. *College Sav. Bank*, 119 S. Ct. at 2233.

97. *But see id.* at 2239 (Breyer, J., dissenting).

The ancient world understood the need to divide sovereign power among a nation’s citizens, thereby creating government in which all would exercise that power; and they called “free” the citizens who exercised that power so divided. Our Nation’s founders understood the same, for they wrote a Constitution that divided governmental authority, retained great power at state and local levels, and which foresaw, indeed assumed, democratic citizen participation in government at all levels, including levels that facilitated citizen participation closer to a citizen’s home.

*Id.*

## 2. Dual Sovereignty and Federal Power

A second consistent theme of the Court's recent constitutional federalism decisions has been its insistence that the federal government is one of enumerated powers, a core premise of dual sovereignty. For example, Justice O'Connor asserts that: "every schoolchild learns [that] our Constitution establishes a system of dual sovereignty between the States and the Federal Government. . . . [U]nder our federal system, the States possess sovereignty concurrent with that of the Federal Government, subject only to limitations imposed by the Supremacy Clause."<sup>98</sup> For dual sovereignty to protect liberty, it is also necessary both that "[t]he Constitution created a Federal Government of limited powers"<sup>99</sup> and that the Court continue to limit those powers. But the jurisprudence of the post-New Deal Court is founded on deference to Congress's assertion of power over virtually all activity that takes place within the United States, no matter how remote its connection to any national interest.<sup>100</sup> And with one minor exception,<sup>101</sup> the Court has not departed from this deference in its constitutional federalism cases.

This continued reliance on dual sovereignty has muddled the Court's efforts to breathe life into the Tenth Amendment. Justice O'Connor, writing for the Court in *New York*, treated the Tenth Amendment question as one of dual sovereignty: "whether particular sovereign powers have been granted by the Constitution to the Federal Government or have been retained by the States."<sup>102</sup> The result is a rather strained insistence that the question of where Congress's power under the Commerce Clause ends, and where the powers exclusively reserved to the states by the Tenth Amendment begin, are "mirror images of each other."<sup>103</sup> Despite the transparency of the fiction, it is probably a necessary one in order to evade the force of the Court's New Deal interpretation of the Tenth Amendment as stating "but a truism that all is

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98. *Gregory*, 501 U.S. at 457.

99. *Id.*

100. See Edward S. Corwin, *The Passing of Dual Federalism*, 36 VA. L. REV. 1 (1950) (chronicling the New Deal's destruction of dual sovereignty).

101. See *infra* text accompanying notes 107-113 (describing *Lopez* as a minor exception to the courts trend toward deference).

102. *New York*, 505 U.S. at 155. See also H. Jefferson Powell, *The Oldest Question of Constitutional Law*, 79 VA. L. REV. 633, 650 (1993) ("O'Connor's federalism thus disavows the *National League of Cities* approach, which identified the federalism limit on congressional power as an analogue to Bill of Rights limitations, a trump that invalidates legislation that is within the scope of a power delegated to Congress.").

103. *New York*, 505 U.S. at 156 ("If a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States; if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress.") (citations omitted).

retained which has not been surrendered.”<sup>104</sup> This line-drawing between state and federal power sits rather awkwardly with the Court’s repeated acquiescence in Congress’s appropriation of a general police power under the Commerce Clause. And the Court has not questioned the scope of that interpretation of the Commerce Clause in any of its Tenth Amendment cases.<sup>105</sup> Nonetheless, the Court has found that state sovereignty limits congressional action in a number of other cases. For those who believe that constitutional limits should be grounded in the Constitution’s text, Justice Rehnquist was closer to the mark when he asserted that the Tenth Amendment, like other provisions of the Bill of Rights, is an independent limit on Congress’s enumerated powers.<sup>106</sup> The Court is more likely to develop a coherent constitutional federalism doctrine if it acknowledges that state sovereignty may trump otherwise valid exercises of federal power.

## *B. The Court’s Decisions and Their Implications for Individual Liberty*

### *1. Limits on the Commerce Clause Power*

The Court’s long-standing deference to federal power made *United States v. Lopez*<sup>107</sup> the most startling of the Court’s recent constitutional federalism cases. *Lopez* recognized limits, for the first time in half a century, on Congress’s ability “[t]o regulate Commerce . . . among the several States.”<sup>108</sup> The Court found that Congress had exceeded its authority by prohibiting

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104. *Darby*, 312 U.S. at 124.

105. See, e.g., *New York*, 505 U.S. at 157.

The Federal Government undertakes activities today that would have been unimaginable to the Framers in two senses; first, because the Framers would not have conceived that any government would conduct such activities; and second, because the Framers would not have believed that the Federal Government, rather than the States, would assume such responsibilities. Yet the powers conferred upon the Federal Government by the Constitution were phrased in language broad enough to allow for the expansion of the Federal Government’s role.

*Id.*

106. See *Fry v. United States*, 421 U.S. 542, 553 (1975) (Rehnquist, J., dissenting).

In this case . . . the State is not simply asserting an absence of congressional legislative authority, but rather is asserting an affirmative constitutional right, inherent in its capacity as a State, to be free from such congressionally asserted authority. Whether such a claim on the part of a State should prevail against congressional authority is quite a different question, but it is surely no answer to the claim to say that “a state can no more deny the power if its exercise has been authorized by Congress than can an individual.”

*Id.* (quoting *United States v. California*, 297 U.S. 175, 185 (1936)).

107. 514 U.S. 549 (1995).

108. U.S. CONST. art. I, § 8 cl. 3. See Erwin Chemerinsky, *The Values of Federalism*, 47 FLA. L. REV. 499, 517 (1995) (“From 1936 until April 26, 1995, the Supreme Court did not declare unconstitutional even one federal law as exceeding the scope of Congress’ powers under the Commerce Clause.”).



possession of a gun within 1000 feet of a school. The Court's concern for state sovereignty is clear: "[t]o uphold the Government's contentions here, we would have to pile inference upon inference in a manner that would bid fair to convert congressional authority under the Commerce Clause to a general police power of the sort retained by the States."<sup>109</sup>

Congress's authority had to be limited in order to preserve an area, however small, of exclusive state authority, an essential premise of dual sovereignty. *Lopez* ensures that the Court can still plausibly claim that the national government is one of enumerated powers. And the decision may serve the salutary purpose of reminding Congress that it does not have unlimited power.<sup>110</sup> *Lopez* does not, however, challenge the New Deal Court's broad reading of the Commerce Clause.<sup>111</sup> Indeed, it is not clear that *Lopez* puts any substantive limit on Congress's power; it may simply require that Congress use a different form.<sup>112</sup>

*Lopez* also does little to encourage the state regulatory competition that might promote freedom. The authority reserved exclusively to the states by *Lopez* is so narrow that virtually every state will exercise it to its full extent. Moreover, there will be little variation in that state regulation, as the holding in *Lopez* is unlikely to encourage states to allow students to bring guns to schools.<sup>113</sup> *Lopez* is hardly a stimulus that will generate competition among the states on the appropriate regulation of guns. Thus, while *Lopez* was a surprising decision, it does little to enhance individual liberty.

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109. *Lopez*, 514 U.S. at 567.

110. See Jenna Bednar & William N. Eskridge, Jr., *Steadying the Court's "Unsteady Path": A Theory of Judicial Enforcement of Federalism*, 68 S. CAL. L. REV. 1447, 1483 (1995) ("There is probably some relationship between the perception that there are no effective limits on Congress' power, and Congress behaving as though its power is unlimited.").

111. See *Lopez*, 514 U.S. at 556. New Deal cases

ushered in an era of Commerce Clause jurisprudence that greatly expanded the previously defined authority of Congress under that Clause. In part, this was a recognition of the great changes that had occurred in the way business was carried on in this country. Enterprises that had once been local or at most regional in nature had become national in scope. But the doctrinal change also reflected a view that earlier Commerce Clause cases artificially had constrained the authority of Congress to regulate interstate commerce.

*Id.* Of the Justices in the majority, only Justice Thomas was willing to say that the New Deal cases went too far in deferring to Congress's assumption of a general police power. See *id.* at 599 (Thomas, J., concurring) ("If anything, the 'wrong turn' was the Court's dramatic departure in the 1930's from a century and a half of precedent.").

112. The Court did not call into question its prior rulings upholding federal statutes regulating gun possession when the gun had traveled in interstate commerce. See *Lopez*, 514 U.S. at 561-62 (discussing *United States v. Bass*, 404 U.S. 336 (1971), which did not hold as unconstitutional a statute prohibiting felons from possessing guns that had traveled in interstate commerce).

113. See Lessig, *supra* note 43, at 209 ("Was there really a state that wanted to permit gun possession within 1,000 feet of a school, but which was disallowed by Congress's statute?").

## 2. *The Clear Statement Rule*

The Court's other constitutional federalism cases are likely to have a more significant impact on individual liberty, albeit indirectly. The first glimmer of constitutional federalism's revival came before *Lopez*, in *Gregory v. Ashcroft*.<sup>114</sup> At issue in *Gregory* was whether a provision of the Missouri constitution requiring judges to retire at age seventy was preempted by the Age Discrimination in Employment Act ("ADEA").<sup>115</sup> Justice O'Connor could not muster a majority to rethink whether the Court had achieved a "proper balance" between state and federal power; the absolute supremacy of the federal government went unquestioned.<sup>116</sup>

Rather than limiting federal power by constitutional rule, *Gregory* announced a mode of statutory interpretation informed by federalism concerns. The Court would look for a "plain statement" of Congress's intention to apply a law of general applicability to the states before it construes a statute as having that effect.<sup>117</sup> While Justice O'Connor claimed that her mode of interpretation avoided a "potential constitutional problem,"<sup>118</sup> it is difficult to see what that problem might be after *Garcia*, as the ADEA applies generally to both private and state employers.<sup>119</sup> Congress retained the power to interfere with state sovereignty, as long as it made its intention plain. Further, the rule of interpretation did nothing to directly enhance individual liberty. It merely erected an obstacle to Congress's interference with the states.

*Gregory*'s plain statement rule works only indirectly to preserve liberty. It ensures that states will be put on notice to oppose draconian laws of general applicability that affect their operations so that Congress cannot sneak in regulation of the states through the back door. States will be alerted to the need to join private parties in lobbying against federal legislation, thus creating a more effective lobbying coalition of the sort anticipated by Hamilton.<sup>120</sup> Similar plain statement rules apply to Congress's imposition of conditions on federal grants to the states<sup>121</sup> and to Congress's abrogation of

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114. 501 U.S. 452 (1991).

115. Age Discrimination in Employment Act, 29 U.S.C. §§ 621-634 (1994 & Supp. III 1997).

116. See *Gregory*, 501 U.S. 452.

117. See *id.* at 460-64.

118. *Id.* at 464.

119. See 29 U.S.C. § 633(a) ("The term 'employer' . . . also means a State. . .").

120. See *supra* note 22 and accompanying text. See also Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 5-7 (1988) (discussing the role of state and local governments in organizing opposition to federal policies).

121. See *South Dakota v. Dole*, 483 U.S. 203, 207 (1987) ("[I]f Congress desires to condition the States' receipt of federal funds, it 'must do so unambiguously . . . enabl[ing] the States to exercise their

states' sovereign immunity.<sup>122</sup> By eliminating ambiguity concerning the imposition of federal rules on state governments, these rules ensure that states will serve their liberty-enhancing role as focal points for lobbying against excessive federal regulation.<sup>123</sup> At the same time, the clear statement rule allows the Court to maintain its deferential attitude toward Congress's exercise of a general police power.<sup>124</sup>

### 3. *Commandeering*

Justice O'Connor found a majority for constitutional limits preserving state sovereignty the following term. In *New York v. United States*, the Court rejected Congress's attempt to "commandeer" state legislatures by requiring them to adopt regulations to deal with nuclear waste produced within their boundaries.<sup>125</sup> The Court looked to the early Republic's transition from the Articles of Confederation to the Constitution to justify the anti-commandeering principle.<sup>126</sup> The Court concluded that the primary reason for the Articles' failure was that they had the national government operating through the states, rather than directly governing individuals. The Framers repudiated that practice in favor of "a Constitution in which Congress would exercise its legislative authority directly over individuals rather than over

choice knowingly, cognizant of the consequences of their participation.") (alterations in original) (quoting *Pennhurst Sch. and Hosp. v. Halderman*, 451 U.S. 1, 17 (1981)).

122. See *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 243 (1985) (stating that when "Congress unequivocally expresses this intention in the statutory language," the court may determine that "Congress has abrogated the States' [sovereign] immunity. . .").

123. See Ann Althouse, *Variations on a Theory of Normative Federalism: A Supreme Court Dialogue*, 42 DUKE L.J. 979, 1006 (1993) ("If extra consideration leads to a rejection of the application of a statute to the states, or if legislators shrink from approving of the statute simply because its application to the states becomes conspicuous, that rejection exemplifies the political protection of federalism values touted by *Garcia*."); Rapaczynski, *supra* note 88, at 390.

[T]he independence of the very process of state government, without seriously hampering the national authorities in regulating most private activities, assures the existence of an organizational framework, more efficient than any private institution could provide, that may always be used as an effective tool for bringing together otherwise defenseless individuals with some stake in resisting the overreaching of the national government.

*Id.* See also *Grey*, *supra* note 7 at 617-20 (discussing advantages and criticisms of clear statement rule).

124. See *Bednar & Eskridge, Jr.*, *supra* note 110 at 1487 ("A clear statement approach rather than a constitutional approach to state burdens is also one with fewer political risks for the Court, because Congress can assert its preferences by overriding the Court with requisite clear statement (as it did in response to *Agtascodezo*)").

125. See 505 U.S. 144 (1992). Justice O'Connor stated that "Congress may not simply 'commandeer[r] the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.'" *Id.* at 161 (alterations in original) (quoting *Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc.*, 452 U.S. 264, 288 (1981)).

126. See *id.* at 163-66.

States.”<sup>127</sup>

The Court also offered two normative justifications for the anti-commandeering rule. First, it justified its decision as enhancing accountability to the electorate. The Court contrasted a state’s decision to voluntarily participate in a federal program, for which state officials would remain accountable to their constituents, with state regulation compelled by the federal government. The Court worried that in the compelled case, “it may be state officials who will bear the brunt of public disapproval, while the federal officials who devised the regulatory program may remain insulated from the electoral ramifications of their decision.”<sup>128</sup> The Court offered a second normative justification in the course of rejecting the notion that New York had acquiesced in the infringement on its sovereignty; the liberty-enhancement rationale offered in *Gregory*. The Court suggested that allowing state officials to consent to federal infringement of their sovereignty could raise accountability problems at both the state and federal levels.<sup>129</sup> These arguments, however, would also apply to federal programs in which state governments were voluntary participants and such voluntary programs are clearly constitutional.<sup>130</sup> Presumably, state politicians have brought the wrath of the electorate on themselves when they voluntarily participate in federal programs.

The Court distinguished voluntary acceptance of federal standards by states. *FERC*, as well as *Hodel*, involved conditional preemptions under which Congress dictated to the states how they would regulate, but only *if* the states chose to regulate.<sup>131</sup> In *New York*, by contrast, Congress was compelling New York to regulate private parties. This regulatory innovation went too far, as “the Constitution has never been understood to confer upon

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127. *Id.* at 165.

128. *Id.* at 169. This accountability rationale has met with some criticism. See Caminker, *supra* note 88, at 1060-74.

129. *New York*, 505 U.S. at 182-83.

[P]owerful incentives might lead both federal and state officials to view departures from the federal structure to be in their personal interests. . . . If a federal official is faced with the alternatives of choosing a location or directing the States to do it, the official may well prefer the latter, as a means of shifting responsibility for the eventual decision. If a state official is faced with the same set of alternatives—choosing a location or having Congress direct the choice of a location—the state official may also prefer the latter, as it may permit the avoidance of personal responsibility. The interests of public official thus may not coincide with the Constitution’s intergovernmental allocation of authority. Where state officials purport to submit to the direction of Congress in this manner, federalism is hardly being advanced.

*Id.*

130. See Hills, *supra* note 48, at 826 (“Such an argument seems to condemn not merely federal laws that commandeer state or local services but also even *voluntary* intergovernmental cooperation.”).

131. See *New York*, 505 U.S. at 161-62.

Congress the ability to require the States to govern according to Congress' instructions."<sup>132</sup> Congress had the power to preempt state regulation, or to regulate directly private parties producing nuclear waste, but it could not compel the states to regulate on behalf of the federal government.

Conditions on federal grants were similarly distinguished as being voluntarily accepted by the states. The spending power conferred upon Congress the authority to direct state regulation by imposing conditions on its grants; the states were uncoerced because they were free to accept or reject the grants.<sup>133</sup> Both conditional preemption and grants to the states were acceptable means of inducing state regulation; only direct coercion of the states' exercise of sovereign authority was off limits. While Congress can *prohibit* states from taking certain actions, or *bribe* them to take actions they otherwise might not take, constitutional federalism prevents Congress from *directing* those actions.<sup>134</sup>

The Court's acceptance of conditional preemption reflects its general deference to the expansion of federal power. Preemption can be distinguished from commandeering by the amount of government regulation created. Congress's power to regulate under the Commerce Clause is practically unlimited, so limiting its preemption power would leave two sets of laws on the books when Congress chooses to regulate.<sup>135</sup> Rather than limiting Congress in this fashion, the Court has permitted Congress to preempt, in the interest of uniformity, even state laws whose purpose is consistent with federal regulation.<sup>136</sup> Congress can establish a federal ceiling, as well as a federal baseline; it can free commerce, as well as obstruct it. Thus, preemption reduces the governmental burden imposed on citizens because they need only comply with one set of laws. Commandeering, by contrast, allows the federal government to regulate more because it does not bear the full cost of regulation. Commandeering may induce states to regulate less because of resource constraints, but that outcome is uncertain; states may

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132. *Id.* at 162 (citing *Coyle v. Smith*, 221 U.S. 559, 565 (1911)).

133. *See id.* at 167. To be sure, this ignores the "race to the bottom" created by conditional spending as states compete for federal money by surrendering their sovereignty. *See Yoo, supra* note 17, at 1401 ("If the fifty states are in competition for these funds, then the states that are most willing to surrender some of their autonomy will be the ones that acquire federal funds with the greatest ease.").

134. *See Caminker, supra* note 88, at 1009 ("None of these accepted strategies involves compulsion of affirmative state action, which seems more viscerally to treat states as subordinate agents of the federal government.").

135. Two sets of laws will mean a greater burden. *See Bednar & Eskridge, supra* note 110, at 1463 ("In our modern regulatory state, two layers of government seem as likely to impose double as to impose half the burdens that a single layer of government would impose.").

136. *See Gade v. National Solid Wastes Management Ass'n*, 505 U.S. 88 (1992) (holding that two Illinois acts were preempted by OSHA).

simply levy a heavier tax burden on their citizens to fund their added responsibilities. Competition is unlikely to constrain this added tax burden because the federal government has imposed responsibilities on the states equally.

Conditional preemption, on its face, is more difficult to justify than ordinary preemption. It allows the federal government to extend its reach by controlling state regulation. But the expanded federal power conditional preemption creates necessarily reduces the reach of state government. States are left to enforce federal standards rather than their own, but private parties need only comply with one set of standards. The state has demonstrated that it would regulate absent the federal regulation. Otherwise, the state would not bother to enforce the federal standards. Thus, conditional preemption merely exchanges a federal burden for a state one, thereby adding minimal governmental burden.<sup>137</sup> Commandeering, on the other hand, may require the states to regulate in an area previously unregulated. This would create an additional governmental burden directed by the federal government at the states' expense. This rationale may provide a more persuasive explanation for cases like *FERC* than the notion of state consent.<sup>138</sup> If the states' "choice" of whether to regulate seems illusory, it is because they believe that regulation is essential, and they would have regulated with or without the federal intervention.

The *New York* Court also distinguished prior decisions upholding the application of laws of general applicability to the states.<sup>139</sup> The law at issue in *New York* ran afoul of constitutional federalism principles because it was directed at the states in their sovereign capacities. The Court stated this conclusion in terms remarkably similar to the argument that it had rejected in *FERC*: "The allocation of power contained in the Commerce Clause . . . authorizes Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce."<sup>140</sup> The dissenters in *New York* found the distinction between laws of general applicability and those directed specifically at the states unpersuasive. "An incursion on state sovereignty hardly seems more

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137. To be sure, substituting a state regulation for a federal one eliminates the competition between states, but this is an inevitable by-product of federalization and the Court's deference to federal power.

138. See *Printz*, 521 U.S. at 965-66 (Stevens, J., dissenting) ("The state commissions could avoid [the obligation to consider federal standards] only by ceasing regulation in the field, a 'choice' that we recognized was realistically foreclosed, since Congress had put forward no alternative regulatory scheme to govern this very important area.").

139. See *New York*, 505 U.S. at 160.

140. *Id.* at 166.

constitutionally acceptable if the federal statute that 'commands' specific action also applies to private parties. The alleged diminution in state authority over its own affairs is not any less because the federal mandate restricts the activities of private parties."<sup>141</sup>

But allowing Congress to regulate state operations cannot easily be carved out of federal power to regulate the economy generally. One of the rationales justifying the regulation of *intrastate* commerce is that it is "an essential part of a larger regulation of economic activity, in which the regulatory scheme could be undercut unless intrastate activity were regulated."<sup>142</sup> An analogous rationale justifies imposing rules of general applicability on the states. As the court pointed out in *Fry v. United States*<sup>143</sup> in upholding a federal law freezing wages as applied to state employees,

[i]n 1971, when the freeze was activated, state and local governmental employees composed 14% of the Nation's work force. It seems inescapable that the effectiveness of federal action would have been drastically impaired if wage increases to this sizeable group of employees were left outside the reach of these emergency federal wage controls.<sup>144</sup>

Regulation of state economic activity may be essential to ensure the effectiveness of regulation generally when the states are major participants in the regulated area.

The distinction between laws of general applicability and those directed specifically at the states nonetheless can be justified as preserving individual liberty. As Judge Easterbrook has recognized,

[s]o long as public market participants are treated the same as private ones, they enjoy the protection the latter have been able to secure from the legislature; and as Congress is not about to destroy private industry (think what that would do to the tax base!) it can not hobble the states either.<sup>145</sup>

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141. *Id.* at 201-02 (White, J., concurring in part and dissenting in part). *See also* *Printz*, 521 U.S. at 961 (Stevens, J., dissenting) ("A structural problem that vanishes when the statute affects private individuals as well as public officials is not much of a structural problem."); Matthew D. Adler & Seth F. Kreimer, *The New Etiquette of Federalism: New York, Printz, and Yeskey*, 1998 SUP. CT. REV. 71, 110-15 (criticizing distinction between laws of general applicability and laws directed toward the states).

142. *Lopez*, 514 U.S. at 561.

143. 421 U.S. 542 (1975).

144. *Fry* 421 U.S. at 548 (1975) (citation omitted).

145. *Travis v. Reno*, 163 F.3d 1000, 1003 (7th Cir. 1998). *See also* *Jackson*, *supra* note 3, at 2207.

[W]hen a state is subject to a statute that applies to many private entities, states are protected in at

The converse is also true. States' opposition to laws of general applicability will help protect private industry from overreaching by the national government. By contrast, "[a] state-specific law does not provide states with the protection that private groups have arranged for themselves; it could in principle be a vehicle of destruction."<sup>146</sup>

Judge Easterbrook took a wrong step, however, when he allowed the existence of similar restrictions in other laws to qualify a law directed solely at the states as being one of general applicability. Private parties who are already subject to federal restrictions are unlikely to resist when Congress proposes analogous restrictions on the states.<sup>147</sup> Timing matters; by legislating in a piecemeal fashion, Congress can adopt a strategy of divide and conquer.<sup>148</sup>

Despite this risk, the Court held that the requirements imposed by Congress on state motor vehicle departments in the Driver's Privacy Protection Act<sup>149</sup> were constitutional.<sup>150</sup> Chief Justice Rehnquist brushed aside South Carolina's argument that the law was not one of general applicability, observing that it "regulates the universe of entities that participate as suppliers to the market for motor vehicle information—the States as initial suppliers of the information in interstate commerce and private resellers or redisclosers of that information in commerce."<sup>151</sup> If such derivative application suffices to make a law one of general applicability, we can expect Congress to exploit this loophole to draft legislation targeting the states under a pretense of general applicability.

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least two ways. First, such a statute—to the extent that it is directed at some significant amount of private activity—is unlikely to be aimed at uniquely governmental functions of states; states would not be "singled out" for the purpose of federal use of their governmental capacities. Second, statutes that fall on private and public interests may be more likely to be closely politically monitored and contested; the legislative process is 'safeguarded' from imprudent decisions not only by the states' representation but also by the general public's representation.

*Id.*

146. *Travis*, 163 F.3d at 1005.

147. See *Zelinsky*, *supra* note 4, at 1410.

Proposals targeted only at [states and localities] leave them isolated in the legislative process, bereft of allies to help reduce the legislative zone of discretion. In contrast, when the legislature considers proposals affecting [states and localities] in the same fashion as other persons . . . , the localities have partners in the lawmaking process, obviating the need for special care of [local] interests.

*Id.*

148. To be sure, the Court approved a separate law imposing a tax on state-issued bearer bonds in *South Carolina v. Baker*, but a separate regime was necessary because of the tax free status of state bonds, not enjoyed by corporate issuers. 485 U.S. at 527.

149. Driver's Privacy Protection Act of 1994, 18 U.S.C. §§ 2721-2725.

150. *Reno v. Condon*, 120 S. Ct. 666 (2000).

151. *Id.* at 672.



While Congress should ordinarily be required to regulate states in the same manner as private entities, some states functions may have no private analogue. A law that regulates the states separately from private employers could still pass constitutional muster, but only if Congress imposes the same rule on the federal government. By requiring Congress to restrict itself we can be confident that Congress is not using the law to undermine the sovereignty of the states. If the law applies to both federal and state government, the states have not been singled out.<sup>152</sup>

*Printz v. United States* brought a second application of the anti-commandeering principle.<sup>153</sup> The *Printz* Court struck down a federal statute that required state law enforcement officers to check the background of prospective handgun purchasers. The anti-commandeering rule of *New York* was extended to prohibit the federal government from enlisting state executive branch officials for federal regulatory purposes. The Court insisted that “[i]t is an essential attribute of the States’ retained sovereignty that they remain independent and autonomous within their proper sphere of authority.”<sup>154</sup> Congress could not implement its policy choices by enlisting state officials as federal bureaucrats. Notably, the Court did not rest its conclusion solely on the Tenth Amendment, but also invoked “reasonable implications” from other constitutional provisions, suggesting a broader scope for the protection of state sovereignty.<sup>155</sup>

Justice Stevens, in dissent, challenged the majority’s contention that the anti-commandeering rule protects liberty:

Perversely, the majority’s rule seems more likely to damage than to preserve the safeguards against tyranny provided by the existence of vital state governments. By limiting the ability of the Federal Government to enlist state officials in the implementation of its

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152. Cf. Evan H. Caminker, *Printz, State Sovereignty, and the Limits of Formalism*, 1997 SUP. CT. REV. 199, 246.

Although Justice Scalia surely recognizes that generally applicable laws can impose the same type of burden on state executives as state-targeted commandeering statutes, his focus ... on the “whole object of the law” suggests that only laws that *particularly* target state executives violate the “very principle of separate state sovereignty” he has constructed. On this view, the states’ sovereign status provides them with a right not to be singled out by Congress on the basis of their statehood, and nothing more.

*Id.*

153. 521 U.S. 898.

154. *Id.* at 928.

155. *Id.* at 924 n.13 (“Our system of dual sovereignty is reflected in numerous constitutional provisions and not only those, like the Tenth Amendment, that speak to the point explicitly. It is not at all unusual for our resolution of a significant constitutional question to rest upon reasonable implications.”).

programs, the Court creates incentives for the National Government to aggrandize itself. In the name of States' rights, the majority would have the Federal Government create vast national bureaucracies to implement its policies.<sup>156</sup>

Justice Stevens confuses size with aggrandizement, and thus, his fear of a gigantic federal bureaucracy arising from the anti-commandeering principle seems overblown. The federal government's interference with private choice does not vary with reliance on federal or state bureaucrats; the only difference is which level of government pays. The budget constraint is the only limit that Congress seems to take seriously. Massive deficits and the discipline imposed by the international market for debt are the only structural tools that have been shown to limit Congress's thirst to expand the size and scope of the federal government.

Apart from liberty concerns, it is difficult to see how the anti-commandeering rule could impair government effectiveness. Making Congress pay for state services does not seem like a huge burden to place on the federal government.<sup>157</sup> If Congress doesn't like the price charged by the states for regulating private conduct, it can hire its own administrators.<sup>158</sup> And if Congress is unwilling to pay this price, it suggests that the policy's benefits may not exceed its costs.<sup>159</sup>

Justice Souter suggests that Congress should be allowed to commandeer, but be required to pay compensation *ex post*.<sup>160</sup> This suggestion makes little sense given that Congress can bargain with the states. The barriers to a transaction that would suggest the need for a taking power, such as potential holdout problems, can be overcome by the usual logrolling that facilitates

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156. *Id.* at 959 (Stevens, J., dissenting).

157. *See id.* at 936 (O'Connor, J., concurring) ("Congress is . . . free to amend the interim program to provide for its continuance on a contractual basis with the States if it wishes, as it does with a number of other federal programs.").

158. *See Hills, supra* note 48, at 893-900 (arguing that federal commandeering of state resources is inefficient).

159. *But see* Caminker, *supra* note 88, at 1084.

Requiring Congress to establish local federal machinery would, at a minimum, drive up the cost of the federal program and make Congress divert federal resources from other projects or raise federal taxes, yet it would bring no compensating social gain. In more extreme cases, the requirement might make the program prohibitively expensive or administratively infeasible, in which case the federal goal remains unrealized. . . . [A]t least when the total implementation cost is relatively low . . . unfunded mandates are reasonable, since federal reimbursement would itself entail potentially substantial transaction costs which represent deadweight social losses.

*Id.*

160. *See Printz*, 521 U.S. at 975-76 (Souter, J., dissenting) ("I do not read any of The Federalist material as requiring the conclusion that Congress could require administrative support without an obligation to pay fair value for it.")

most legislation.<sup>161</sup> The more substantial objection is that withholding money under federal programs, which the Court allows, can be just as coercive as commandeering or subjecting states to suit.<sup>162</sup> But that objection fails in the absence of any limits on the federal spending power.<sup>163</sup>

#### 4. Sovereign Immunity

The final piece of the Court's revived constitutional federalism has been a resuscitation of sovereign immunity. The Court has repeatedly rebuffed congressional attempts to use its Article I powers to abrogate the states' Eleventh Amendment immunity from damages.<sup>164</sup> The Court also rejected the proposition that a state's involvement in a commercial activity regulated by Congress could be construed as a waiver of its sovereign immunity.<sup>165</sup> Finally, in *Alden v. Maine* the Court held that Congress could not abrogate the states' sovereign immunity in the states' own courts.<sup>166</sup>

The Court's strong defense of sovereign immunity can be reconciled with a freedom-enhancing vision of constitutional federalism. Freeing the states from paying damages reduces Congress's ability to enlist private individuals to help impose its policies on the states. This is another application of the budget constraint as a means of preventing federal aggrandizement.<sup>167</sup> If

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161. See Hills, *supra* note 48, at 934-38 (criticizing Souter's theory). The ability of the federal government to solicit voluntary state cooperation also seems sufficient answer to the criticism that the anti-commandeering rule precludes federal use of state officials in an emergency. See, e.g. Jackson, *supra* note 3, at 2212.

Although reasonable minds may disagree whether the Brady Act was responding to an emergency, as the dissent points out, emergencies on occasion do arise—in the event of sudden war, for example, [Printz] would preclude the mandatory use of state officials to administer a draft law, or in the event of a hazardous waste emergency, to compel the involvement of state officers in response.

*Id.* In the case of a genuine emergency, it is hard to imagine that state officials would refuse their cooperation. And the concept of "emergency" is sufficiently flexible that we should be hesitant before giving Congress the power to commandeer state officials upon invoking an emergency.

162. See *College Sav. Bank*, 527 U.S. 666; 119 S. Ct. at 2236 (Breyer, J., dissenting) ("Given the amount of money at stake, it may be harder, not easier, for a State to refuse highway funds than to refrain from entering the investment services business.").

163. See *supra* notes 107-113 and accompanying text.

164. See *Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 627; *College Sav. Bank*, 527 U.S. 666; 119 S. Ct. at 2223.

165. See *College Sav. Bank*, 527 U.S. 666; 119 S. Ct. at 2224-31. This case suggests that Congress's power of conditional preemption has at least one limit: Congress cannot force the states to waive their sovereign immunity from damages. Sovereign immunity may be a special case, or it may suggest that the current Court is open to rethinking the broad conditional preemption power that it recognized in *Hodel* and *FERC*. Thanks to Evan Caminker for this point.

166. *Alden*, 527 U.S. 706; 119 S. Ct. 2240. *Alden* is discussed below at *infra* notes 212-220 and accompanying text.

167. The Court also seemed skeptical that Congress was imposing a rule on state government that

Congress wants to control the states, it has to pay the price for attorneys at the Department of Justice to bring suit.<sup>168</sup> Allowing a plethora of “private attorneys general” to enforce rules against the states would permit off-budget expansion of federal government power over the states in the same manner as commandeering.<sup>169</sup> Making Congress pay the full price of enforcement requires cost internalization; Congress will impose fewer policies on the states if it has to pay the full cost of administering those policies via the court system.<sup>170</sup> To be sure, freeing states from paying damages may undermine the purposes of regulation by putting private competitors of the states at a competitive disadvantage,<sup>171</sup> but this result enhances individual liberty as the disadvantaged businesses will lobby Congress for relief. And any undermining of deterrence is likely to be minimal, given that suits against localities and individual government officers remain available.<sup>172</sup> Thus, “Congress has ample means to ensure compliance with valid federal laws, but it must respect the sovereignty of the States.”<sup>173</sup> State sovereign immunity encourages the states to serve as a counterweight to federal power.

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it had declined to impose on the federal government. *See Alden*, at 2264 (“It is unquestioned that the Federal Government retains its own immunity from suit not only in state tribunals but also in its own courts.”). Would *Alden* have come out differently if the United States had waived its immunity from suit? A less expansive protection of sovereign immunity would allow Congress to impose rules on state governments only if it had imposed them on the federal government as well. This would greatly discourage rules being imposed on the states. However, this would come at a cost of removing the states as focal points for lobbying on behalf of the private sector.

168. *See College Sav. Bank*, 527 U.S. 666; 119 S. Ct. at 2240 (Breyer, J., dissenting) (“Congress . . . might create a federal damages-collecting ‘enforcement’ bureaucracy charged with responsibilities that Congress would prefer to place in the hands of States or private citizens.”). *Cf. Alden*, 527 U.S. 706, 119 S. Ct. at 2269 (“despite specific statutory authorization [under 29 U.S.C. § 216(c)], the United States apparently found the same interests insufficient to justify sending even a single attorney to Maine to prosecute this litigation.”).

169. *See Frank B. Cross, Realism about Federalism*, 74 N.Y.U. L. REV. 1304, 1323 (1999) (arguing that the Court’s recent sovereign immunity decisions “could be seen as mere stalking horses for an antiregulatory ideological conservative agenda” or “as part of a conservative antitort plaintiff agenda”).

170. *See Alden*, 527 U.S. 706, 119 S. Ct. at 2267 (“Suits brought by the United States itself require the exercise of political responsibility for each suit prosecuted against a State, a control which is absent from a broad delegation to private persons to sue nonconsenting States.”).

171. *See College Sav. Bank*, 527 U.S. 666, 119 S. Ct. at 2235 (Breyer, J., dissenting).

[A] Congress that includes the State not only within its substantive regulatory rules but also (expressly) within a related system of private remedies likely believes that a remedial exemption would similarly threaten that program. It thereby avoids an enforcement gap which, when allied with the pressure of a competitive marketplace, could place the State’s regulated private competitors at a significant disadvantage.

*Id.* (citation omitted).

172. *See Alden*, 527 U.S. 706, 119 S. Ct. at 2267 (“sovereign immunity . . . bars suits against States but not lesser entities”). And those suits will still attract plaintiffs’ attorneys because sovereign immunity will not bar the payment of attorneys’ fees by those entities and individuals.

173. *Alden*, 527 U.S. 706, 119 S. Ct. at 2268.

In sum, the Court has used its revived constitutional federalism sparingly. The Court by and large has not challenged directly the scope of federal power. It instead has protected the role of the states as bulwarks against federal overreaching by placing narrow constraints on the federal government's power over the states. Those constraints, taken together, encourage the states to act as focal points against the expansion of federal power and prevent the federal government from using the state governments as an off-budget resource. Rather than abandoning the protection of state sovereignty to the political process, the Court has used constitutional federalism to ensure that the states will have the incentives and resources to play an active role in the political process. This result harnesses the states in the effort to preserve individual liberty.

### III. CONSTITUTIONAL FEDERALISM AND STATE COURTS

This Part is divided into two sections. The first section analyzes the Court's decisions discussing Congress's power to control state courts. The second section looks at the "judicial exception" to the anti-commandeering principle announced in *New York* and *Printz*, and the limits to that exception announced in *Alden*.

#### A. Congress's Power over State Courts

State courts have not been immune from Congress's expansion of power. Congress has the same authority to preempt substantive law imposed by state courts as it does state legislation.<sup>174</sup> And Congress has the power to preempt state tort claims,<sup>175</sup> even if it leaves an injured party without a remedy.<sup>176</sup> But Congress's control over state court procedures is less clear. The early doctrine of dual sovereignty led to strong statements, albeit in dicta, that Congress lacked the power to control state court adjudication:

There are within the territorial limits of each State two governments, restricted in their spheres of action, but independent of

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174. See *Sperry v. Florida*, 373 U.S. 379, 403 (1963) ("The authority of Congress is no less when the state power which it displaces would otherwise have been exercised by the state judiciary rather than by the state legislature.").

175. See *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981) (finding that state common law may be preempted by federal law); Grey, *supra* note 7, at 607 ("There is no question that the federal government has the power under the Commerce Clause to preempt state tort claims.").

176. See *Duke Power v. Carolina Envtl. Study Group*, 438 U.S. 59, 88 (1978) (finding no constitutional requirement that federal laws preempting state causes of action "either duplicate the recovery at common law or provide a reasonable substitute remedy").

each other, and supreme within their respective spheres. Each has its separate departments; each has its distinct laws, and each has its own tribunals for their enforcement. Neither government can intrude within the jurisdiction, or authorize any interference therein by its judicial officers with the action of the other.<sup>177</sup>

The conclusion that states are supreme in determining state court procedures has been repeated more recently. In 1997, the Court stated that “[w]e have made it quite clear that it is a matter for each State to decide how to structure its judicial system.”<sup>178</sup>

Despite the Court’s “clear” position, these statements cannot be taken at face value. The Court has afforded Congress broad authority to dictate when state courts will have jurisdiction over federal claims. State courts have jurisdiction over federal causes of action unless Congress has provided for exclusive federal jurisdiction.<sup>179</sup> This conferral of jurisdiction on state courts is mandatory, rather than permissive.<sup>180</sup> State courts are required to treat federal law as part of the law of the state.<sup>181</sup> Not only can Congress require that state courts hear federal claims, Congress can also dictate that state courts can hear some questions raised by a federal law, while prohibiting

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177. *Tarble’s Case*, 80 U.S. (13 Wall.) 397, 406 (1871). *See also id.* at 407-08.

Such being the distinct and independent character of the two governments, within their respective spheres of action, it follows that neither can intrude with its judicial process into the domain of the other, except so far as such intrusion may be necessary on the part of the National government to preserve its rightful supremacy in cases of conflict of authority. In their laws, and mode of enforcement, neither is responsible to the other. How their respective laws shall be enacted; how they shall be carried into execution; and in what tribunals, or by what officers; and how much discretion, or whether any at all shall be vested in their officers, are matters subject to their own control, and in the regulation of which neither can interfere with the other.

*Id.*

178. *Johnson v. Fankell*, 520 U.S. 911, 922 n.13 (1997). *See also* *Felder v. Casey*, 487 U.S. 131, 138 (1988) (“No one disputes the general and unassailable proposition. . . that States may establish the rules of procedure governing litigation in their own courts.”); *Fay v. Noia*, 372 U.S. 391, 466-67 (1963) (Harlan, J., dissenting).

For this Court to go beyond the adequacy of the state ground and to review and determine the correctness of that ground on its merits would . . . be to assume full control over a State’s procedures for the administration of its own criminal justice. This is and must be beyond our power if the federal system is to exist in substance as well as form. The right of the State to regulate its own procedures governing the conduct of litigants in its courts, and its interest in supervision of those procedures, stand on the same constitutional plane as its right and interest in framing ‘substantive’ laws governing other aspects of the conduct of those within its borders.

*Id.*

179. *See* *Plaquemines Tropical Fruit Co. v. Henderson*, 170 U.S. 511, 521 (1898).

180. *See* *McKnett v. St. Louis & San Francisco Ry. Co.*, 292 U.S. 230, 233-34 (1934) (“[T]he Federal Constitution prohibits state courts of general jurisdiction from refusing to [enforce FELA] solely because the suit is brought under a federal law.”).

181. *See* *Testa v. Katt*, 330 U.S. 386, 393 (1947) (“the policy of the federal Act is the prevailing policy in every state.”).

others. Under the Emergency Price Control Act of 1942,<sup>182</sup> Congress authorized the law's administrator to bring enforcement actions in either federal or state court. But challenges to the Price Control Act could only be brought in a special federal court established by the law.<sup>183</sup> The Court rejected a constitutional challenge to this arrangement, holding that "the authority of Congress to withhold all jurisdiction from the state courts obviously includes the power to restrict the occasions when that jurisdiction may be invoked."<sup>184</sup> Thus, Congress can selectively deny state courts jurisdiction over federal questions.<sup>185</sup> In sum, Congress clearly has broad power to dictate when state courts will decide federal causes of action.<sup>186</sup>

More relevant to the question raised by the Uniform Act are cases holding that Congress can limit the jurisdiction of state courts to hear *state* law causes of action. Section 2 of the Federal Arbitration Act<sup>187</sup> withdraws "the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."<sup>188</sup> The Court has held that Congress has the power under the Commerce Clause to adopt this prohibition on state court jurisdiction over both federal and state law claims, as long as the transaction involves interstate commerce.<sup>189</sup> Thus, the Commerce Clause grants authority to Congress to preclude state courts from adjudicating state law actions, at least when those actions affect interstate commerce.

Congress is not limited to merely restricting state court jurisdiction; it can also impose affirmative obligations on state courts when they adjudicate federal claims. State courts generally can apply state procedural rules; they are not bound to follow the Federal Rules of Civil Procedure when adjudicating federal causes of action.<sup>190</sup> But state courts cannot apply rules of

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182. 56 Stat. 23, *repealed by* Price Control Extension Act of 1946, ch.671, § 1, 60 Stat. 663, 664.

183. *See Bowles v. Willingham*, 321 U.S. 503, 510-11 (1944).

184. *Id.* at 512.

185. The reverse is not true; a state cannot limit the ability of a federal court to hear a case arising out of state law within the jurisdiction of the federal court. Thus, states cannot control the adjudication of state law causes of action by controlling the forum. *See Railway Co. v. Whitton's Administrator*, 80 U.S. (13 Wall.) 270, 286 (1871) (stating that a case "cannot be withdrawn from the cognizance of the federal court by any provision of state legislation that it shall only be enforced in a state court").

186. For a review of the historical support for Congress's ability to dictate that state courts hear federal claims, see Saikrishna Bangalore Prakash, *Field Office Federalism*, 79 VA. L. REV. 1957, 2007-32 (1993). Prakash argues that the Continental Congress also exercised this power under the Articles of Confederation. *See id.* at 1967-1971 (chronicling Congress's use of state courts to hear federal claims under the Articles).

187. 9 U.S.C. § 2 (1994).

188. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

189. *See id.* at 11. *See also Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 272 (1995) (declining to overrule *Southland*).

190. *See Johnson v. Fankell*, 520 U.S. 911, 918-19 (1997).

local procedure if they would “impose unnecessary burdens on rights of recovery authorized by federal laws,”<sup>191</sup> even if the rules are facially non-discriminatory.<sup>192</sup> “[T]he Supremacy Clause imposes on state courts a constitutional duty ‘to proceed in such manner that all the substantial rights of the parties under controlling federal law are protected.’”<sup>193</sup> The requirement that state courts not apply procedures that would defeat federal claims is not peculiar to courts, of course; it reflects a general

duty owed to the National Government, on the part of *all* state officials, to enact, enforce, and interpret state law in such fashion as not to obstruct the operation of federal law, and the attendant reality that all state actions constituting such obstruction, even legislative acts, are *ipso facto* invalid.<sup>194</sup>

This obligation to not obstruct federal law flows directly from the first part of the Supremacy Clause.<sup>195</sup>

Congress’s power to control state courts has its limits. State courts of limited jurisdiction are not required to hear federal causes of action if they would not hear an equivalent state law cause of action.<sup>196</sup> Limitations on jurisdiction presumably do not run foul of the rule against defeating federal claims because some court of general jurisdiction would be available to hear the claim. But what if Congress stated its purpose that a federal claim be heard in “any court”? It would seem then that the state’s decision to limit jurisdiction would defeat the stated federal goal. Which rule prevails? The Court has not been called on to resolve this tension, although it has suggested in dicta that such a directive might exceed Congress’s power.<sup>197</sup>

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191. *Brown v. Western Ry. of Alabama*, 338 U.S. 294, 298 (1949) (holding that local rule requiring particularized pleading could not be applied to a federal claim).

192. See *Dice v. Akron, Canton & Youngstown R.R. Co.*, 342 U.S. 359, 362-63 (1952) (holding that the validity of a release of a federal claim must be tried before a jury, even though state procedure allocated such questions to judges); *Felder*, 487 U.S. at 140-41 (1988) (holding that state could not impose “notice of claim” provision on federal claim against state officials).

193. *Felder*, 487 U.S. at 151 (quoting *Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 245 (1942)).

194. *Printz*, 521 U.S. at 913 (citing *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984)).

195. U.S. CONST. art. VI (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land”).

196. See *Herb v. Pitcaim*, 324 U.S. 117, 120-21, 123 (1945).

197. See *Howlett v. Rose*, 496 U.S. 356, 372 (1990) (“The requirement that a state court of competent jurisdiction treat federal law as the law of the land does not necessarily include within it a requirement that the State create a court competent to hear the case in which the federal claim is presented.”). See also *Hart, Jr.*, *supra* note 13, at 507 (arguing that the state court must exercise jurisdiction in such a case, but reserving judgment on the question of whether the states must provide courts to hear federal claims); *Redish & Sklaver*, *supra* note 14, at 105 (“Because the existence of the



### *B. The Judicial Exception to the Anti-Commandeering Rule*

Congress's ability to force state courts to apply federal law sits uneasily with the anti-commandeering principle of *New York* and *Printz*.<sup>198</sup> The Court's constitutional federalism decisions establish that Congress has three mechanisms by which it can control the states: "as a condition of federal spending, in order to avoid the threat of unilateral federal action in the area, or as a part of a program that affects States and private parties alike."<sup>199</sup> The congressional command to enforce federal law does not seem to fit into any of these three categories, as Congress does not provide general funding for state courts; mandating jurisdiction is not an alternative to federal jurisdiction; and finally, the requirement is directed specifically at state courts. Does this mean that Congress is "commandeering" state courts when it charges them with the enforcement of federal law?

The Court's answer has been "Yes," but such commandeering of state courts nonetheless is permitted by the Constitution. The *New York* Court introduced the "judicial exception" to the anti-commandeering principle. The Court found a textual basis for distinguishing cases involving "the well established power of Congress to pass laws enforceable in state courts"<sup>200</sup> in the "Supremacy Clause's provision that federal law 'shall be the supreme Law of the Land.'"<sup>201</sup> The Court also found a structural difference in the practice because it involved:

congressional regulation of individuals, not congressional requirements that States regulate. Federal statutes enforceable in state courts do, in a sense, direct state judges to enforce them, but this sort of federal "direction" of state judges is mandated by the text of the Supremacy Clause. No comparable constitutional provision authorizes Congress to command state legislatures to legislate.<sup>202</sup>

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commandeering power reflects the principle of federal dominance within the structure of judicial federalism, state courts should not be given wide-ranging and effectively unreviewable discretion to ignore federal procedures that might prove to be important to attaining and preserving federal substantive goals.").

198. See Hills, Jr., *supra* note 48, at 933 ("[T]he notion that Rhode Island is somehow impeding the federal government because it wishes to use its own courts for its own claims seems strained. . . . An antidiscrimination norm that is defined so expansively might be viewed as contradicting the argument . . . that the federal government should pay for the services that it receives.").

199. *Printz*, 521 U.S. at 960 (Stevens, J., dissenting) (citing *New York v. United States*, 505 U.S. 144, 160, 167 (1992)).

200. *New York*, 505 U.S. at 178 (citing *Testa v. Keit*, 330 U.S. 389, 402 (1973)).

201. *Id.*

202. *Id.* at 178-79.

The Court's textualist and structuralist arguments can be supported on a functional basis. Congress can direct judges because such commands cannot be separated from its power over individuals. Judges, state or federal, will inevitably encounter federal rights and obligations in the course of resolving disputes. Such federal rights and obligations will be undermined if state courts are not bound by federal law, regardless of whether or not state courts were required to hear federal causes of action. If state courts were free to ignore federal commands, it would undermine Congress's unquestioned authority to regulate private conduct under the Supremacy Clause. Thus, the "judicial exception" to the anti-commandeering rule announced in *New York* is essential to Congress's broad authority to regulate, the cornerstone of the Court's post-New Deal jurisprudence.

In *Printz*, the Court elaborated further on the "judicial exception" to the anti-commandeering rule. Confronted with a plethora of laws enacted by early Congresses imposing duties on state judges, the Court responded that "[t]hese early laws establish . . . that the Constitution was originally understood to permit imposition of an obligation on state *judges* to enforce federal prescriptions, insofar as those prescriptions related to matters appropriate for the judicial power."<sup>203</sup> The Court identified structural, textual and functional bases for this differential treatment of state courts. The structural basis was Article III's provision making the establishment of lower federal courts discretionary with Congress. State courts obviously would have been necessary to hear federal claims if Congress had foregone the creation of lower federal courts.<sup>204</sup> The textual basis was the last part of the Supremacy Clause, which mandates that "the Judges in every State shall be bound" by federal law.<sup>205</sup> Finally, the functional basis was intrinsic in the judicial role:

[U]nlike legislatures and executives, [courts] applied the law of other

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203. *Printz*, 521 U.S. at 907.

204. *See id.* ("Article III, § 1, established only a Supreme Court, and made the creation of lower federal courts optional with the Congress—even though it was obvious that the Supreme Court alone could not hear all federal cases throughout the United States.").

205. *Id.* (citing U.S. CONST. Art. VI, cl. 2). *See also id.* at 928-29 ("Testa stands for the proposition that state courts cannot refuse to apply federal law—a conclusion mandated by the terms of the Supremacy Clause ('the Judges in every State shall be bound [by federal law]')"). Justice Stevens, in dissent, charged that the majority had misread the significance of this language because the majority ignored the clause that comes after it—"any Thing in the Constitution or Laws of any state to the Contrary notwithstanding." *Id.* at 968 n.21 (Stevens, J., dissenting). According to Justice Stevens, "[t]he omitted language . . . makes clear that the specific reference to judges was designed to do nothing more than state a choice of law principle." *Id.* *See also* Caminker, *supra* note 88, at 1034-42 (criticizing the Court's textual distinction of judges from other state actors); Redish & Sklaver, *supra* note 14, at 82-90 (same).

sovereigns all the time. The principle underlying so-called 'transitory' causes of action was that laws which operated elsewhere created obligations in justice that courts of the forum state would enforce. The Constitution itself, in the Full Faith and Credit Clause, generally required such enforcement with respect to obligations arising in other States.<sup>206</sup>

Courts exist to resolve disputes. Implicit in that role is the requirement that judges interpret and enforce the law, from whatever source it may come<sup>207</sup> and that function requires judges to follow commands issued by others, including federal commands. Therefore, being commandeered is inherent in being a judge, whether state or federal.

The *Printz* Court confirms this interpretation of the judicial exception. *Printz* cabined *FERC* as falling within the judicial exception to the anti-commandeering rule. The Court characterized it as a case that "required state administrative agencies to apply federal law while acting in a judicial capacity."<sup>208</sup> States are free to transfer adjudicative functions from a court to an agency, but that transfer does not free state adjudication from "the power of Congress to prescribe . . . that those adjudications must take account of federal law."<sup>209</sup> The Court opined that "FERC would not have been decided the way it was if *nonadjudicative* responsibilities of the state agency were at issue."<sup>210</sup> Administrative agencies, like courts, must follow federal commands in adjudicating disputes.

In *Alden v. Maine*<sup>211</sup> the Court went beyond the text of the Eleventh Amendment to recognize a more general principle of state sovereign immunity, rejecting Congress's efforts to force the states to defend suits for damages in their own courts.<sup>212</sup> *Alden* suggests that commandeering may apply to state courts in at least some form, despite the judicial exception

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206. *Printz*, 521 U.S. at 907 (citations omitted).

207. See Caminker, *supra* note 88, at 1050 ("[I]t has traditionally been understood that part of a court's normal business is entertaining claims arising under the laws of foreign sovereigns when necessary to resolving disputes between parties within its territorial jurisdiction. For example, it is quite common for American courts (state or federal) to apply the laws of other American states or of foreign countries to parties properly before them.").

208. *Printz*, 521 U.S. at 929 (citing *FERC v. Mississippi*, 456 U.S. 742, 759-71 (1982)). See also *Baker*, 485 U.S. at 514 (1988) (construing *FERC* as holding that "Congress had the power to require that state adjudicative bodies adjudicate federal issues and to require that States regulating in a preemptible field consider suggested federal standards and follow federally mandated procedures.") (citing *FERC v. Mississippi*, 456 U.S. 742, 759-67).

209. *Printz*, 521 U.S. at 929 n.14.

210. *Id.*

211. 527 U.S. 706; 119 S. Ct. 2240 (1999).

212. See *id.* at 2246.

identified in *New York* and *Printz*. The Court recognized two constitutional principles that preserve state sovereignty. First, the Constitution reserves to the states “a substantial portion of the Nation’s primary sovereignty, together with the dignity and essential attributes inhering in that status,” i.e., dual sovereignty. “Second, even as to matters within the competence of the National Government, the constitutional design secures the founding generation’s rejection of ‘the concept of a central government that would act upon and through the States’ in favor of ‘a system in which the State and Federal Governments would exercise concurrent authority over the people,’” i.e., the anti-commandeering principle.<sup>213</sup>

Both principles were at stake in *Alden*, and for the first time the Court found that the federal government had commandeered a state *court*: “A power to press a State’s own courts into federal service to coerce the other branches of the State . . . is the power first to turn the State against itself and ultimately to commandeer the entire political machinery of the State against its will and at the behest of individuals.”<sup>214</sup> Perhaps the Court was simply using the language of commandeering loosely in this context, not really intending to place its sovereign immunity holdings within its constitutional federalism doctrine. But if the Court meant more by this reference, we are confronted with several possible interpretations of this statement. Perhaps the use of state courts constitutes the prohibited commandeering. This seems unlikely because it would conflict with Congress’s general power to enlist the state courts in enforcing federal law. The statement could also be interpreted as the use of state courts *against* the state itself as being commandeering. But the state legislature can be required to legislate to make the state’s behavior conform to federal law; even laws of general applicability may require a state to adopt legislation to conform to federal law.<sup>215</sup> Legislation, of course, is simply one of the means by which states control their own behavior, or more accurately, the behavior of their agents through whom they act.<sup>216</sup> Requiring the state to use its own courts to make its behavior conform to federal law hardly seems more objectionable than requiring legislation.

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213. *Id.* at 2247 (citations omitted).

214. *Id.* at 2264.

215. For example, a federal minimum wage law might require the state legislature to adopt a new wage scale for civil servants.

216. See *Baker*, 485 U.S. at 514-15 (rejecting a claim that requiring registration of state-issued bonds qualified as commandeering: “Such ‘commandeering’ is, however, an inevitable consequence of regulating a state activity. Any federal regulation demands compliance. That a State wishing to engage in certain activity must take administrative and sometimes legislative action to comply with federal standards regulating that activity is a commonplace that presents no constitutional defect.”).

The significance of the statement is further undercut by the Court's reliance on Article III's delineation of "the judicial power" to determine the limits of Congress's ability to force jurisdiction on the state courts.<sup>217</sup> The Court stated that there "was no constitutional precept that would admit of a congressional power to require state courts to entertain federal suits which are not within the judicial power of the United States and could not be heard in federal courts."<sup>218</sup> Congress could not be understood to have more power over state courts than it had over federal courts. This suggests that Congress can use the state courts against the state if the United States brings the suit itself because the United States would have the authority under Article III to bring the suit in federal court. Having excluded these other explanations, we are left with the invocation of state court jurisdiction against the state *by a private individual seeking money damages* as the violation of the commandeering principle as it applies to state courts.

This is a significant departure for the commandeering doctrine. Under *New York* and *Printz*, it was the national government's use of state actors to govern the conduct of *private individuals* that violated the anti-commandeering rule. Under *Alden*, it is the national government's attempt to authorize private individuals to use state courts to govern the *state's* conduct that is impermissible.

It is the principle of sovereign immunity that is important here, not the use of state courts. The Court does not want Congress to use its power over state courts to evade sovereign immunity. The budget constraint principle reconciles the seemingly disparate rules of *New York* and *Printz*, on the one hand, and *Alden*, on the other. Commandeering of state legislators and executive branch officials is impermissible because it allows the federal government to regulate on the state's nickel. The result is more government — and thus more interference with individual liberty — than if the federal government were forced to bear the full costs of regulation. Allowing private actors to seek damages from the states in state courts also allows the federal government to regulate at the state's expense. Absent sovereign immunity, the state would be paying plaintiffs and their attorneys for the privilege of having federal law enforced against itself.<sup>219</sup> The *Alden* Court pointedly noted that the "the United States apparently found the [federal interest in

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217. U.S. CONST. art. III, § 1.

218. *Alden*, 119 S. Ct. at 2266.

219. *See id.* at 2264 ("an unlimited congressional power to authorize suits in state court to levy upon the treasuries of the States for compensatory damages, attorney's fees, and even punitive damages could create staggering burdens, giving Congress a power and a leverage over the States that is not contemplated by our constitutional design.").

compensating the States' employees] insufficient to justify sending even a single attorney to Maine to prosecute this litigation."<sup>220</sup>

And the rules that would be enforced are likely to be liberty-reducing, even though they are being enforced against the states rather than private individuals. The statute at issue in *Alden*, the Fair Labor Standards Act of 1938 ("FLSA"), is a good example.<sup>221</sup> The FLSA limits the ability of employers and employees to negotiate over the terms of employment, including hours and wages.<sup>222</sup> It represents an attempt by Congress to protect rents extracted by unionized labor, a powerful interest group. Insofar as sovereign immunity limits enforcement of the FLSA, individual liberty is enhanced, as employees and employers have a greater range of contractual options. But the constraint is a limited one, as Congress continues to have other enforcement options to encourage states to conform to the law.<sup>223</sup>

In this regard, it is well to remember that the principles of federalism that constrain Congress's exercise of its Commerce Clause power have less force when Congress acts pursuant to Section 5 of the Fourteenth Amendment.<sup>224</sup> Such greater congressional power under the Fourteenth Amendment is consistent with a libertarian view of federalism, as the Civil War amendments were adopted to allow the federal government to stop the states' egregious infringements on the liberty of newly-freed slaves. The Civil War amendments establish a special area where the national government can control state conduct to preserve liberty.<sup>225</sup>

Even here, however, Congress's power has its limits,<sup>226</sup> a necessity if Congress is to be prevented from aggrandizing itself under the aegis of liberty protection.<sup>227</sup> *Kimel v. Florida Board of Regents* represents the

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220. *Id.* at 2269.

221. Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (1994 & Supp. III 1997).

222. *See* 29 U.S.C. §§ 206-207.

223. Of course, federal law can still be enforced through suits by the United States, or suits brought against state officers seeking injunctive relief.

224. *See* *EEOC v. Wyoming*, 460 U.S. 226, 243 n.18 (1983) ("reaffirm[ing] that when properly exercising its power under § 5 [of the 14th Amendment] Congress is not limited by the same Tenth Amendment constraints that circumscribe the exercise of its commerce clause powers"). The Civil War amendments "were specifically designed as an expansion of federal power and an intrusion on state sovereignty." *City of Rome v. United States*, 446 U.S. 156, 179 (1980). *See also* Adler & Kreimer, *supra* note 35, at 119-26 (arguing that Congress has fewer state autonomy concerns when it legislates pursuant to the Reconstruction Amendments).

225. The Supreme Court, in addition to Congress, has an important role to play in this regard. *See* Louise Weinberg, *The Power of Congress over Courts in Nonfederal Cases*, 1995 B.Y.U. L. REV. 731, 753-54 (detailing control over state court procedures under the Due Process Clause of the Fourteenth Amendment).

226. *See, e.g., City of Boerne v. Flores*, 521 U.S. 507 (1997) (striking down the Religious Freedom Restoration Act as beyond Congress's enforcement power under Section 5).

227. The Court has restricted itself in this regard by placing limits on habeas review of state court

Court's most recent effort to draw this line.<sup>228</sup> In *Kimel*, the Court rejected Congress's efforts to make the states answerable for money damages under the Age Discrimination in Employment Act ("ADEA").<sup>229</sup> Because the Equal Protection Clause was not intended to prohibit discrimination on the basis of age, requiring the states to pay damages for violating the ADEA was beyond Congress's power to enforce the Fourteenth Amendment.<sup>230</sup>

In this context, the Court's sovereign immunity doctrine is a blunt tool for protecting individual liberty. Statutes such as the ADEA, barring discrimination on some disfavored basis, arguably restrict the freedom of private employers in selecting their employees, a reduction in liberty from the employers' perspective.<sup>231</sup> But the states as employers have no liberty interest worth recognizing. Anti-discrimination laws in that context provide a benefit to the favored class without a corresponding reduction in liberty for the disfavored class because the states — as legal constructs — cannot enjoy liberty the way that individuals do. States are tools for the organization of society and the protection of rights. They are not ends in themselves as humans are. Sovereign immunity may discourage Congress from imposing severe monetary penalties on private employers for discrimination because the states will not have to answer in damages. This potential enhancement of individual liberty seems rather tenuous, however, in light of the discretion that it may give to the states to engage in arbitrary conduct that serves no one's liberty interest.

#### IV. THE CONSTITUTIONALITY OF THE SECURITIES LITIGATION UNIFORM STANDARDS ACT

This Part explains Congress's motives in adopting the Securities Litigation Uniform Standards Act and why it adopted the form of preemption that it did.<sup>232</sup> It then assesses the provisions of the Act for consistency with principles of constitutional federalism. I conclude that the Supreme Court is

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convictions. See Bednar & Eskridge, Jr., *supra* note 110, at 1464 ("If a libertarian, 'double security' theory were taken seriously, the Court's habeas corpus jurisprudence would have to be rethought, for example. Under the banner of 'our federalism,' the Court for twenty years has been curtailing the availability of federal courts to second-guess state court deprivations of individual liberty.").

228. 120 S. Ct. 631 (2000).

229. Age Discrimination in Employment Act, 29 U.S.C. §§ 621-634 (1994 & Supp. III 1997).

230. *Kimel*, 120 S. Ct. at 643-640.

231. To be sure, this reduction in liberty may be justified, as long as it is narrowly tailored to restrict choices made on such arbitrary bases as race.

232. The description of the Uniform Act here is drawn in part from David M. Levine & Adam C. Pritchard, *The Securities Litigation Uniform Standards Act of 1998: The Sun Sets on California's Blue Sky Laws*, 54 BUS. LAW. 1 (1998).

likely to uphold the Uniform Act. This result is consistent with the constrained libertarianism vision of constitutional federalism because the burdens that the Uniform Act places on state courts do not detract from, and in fact may enhance, individual liberty.

#### *A. The Private Securities Litigation Reform Act*

The Uniform Act was adopted to remedy certain problems that had arisen in the implementation of the Private Securities Litigation Reform Act of 1995.<sup>233</sup> The Reform Act significantly rewrote the rules governing private federal securities fraud lawsuits. The Reform Act raised the bar at several points in the litigation process, making it more difficult for plaintiffs to bring these actions.<sup>234</sup> The provisions relevant to the subsequent adoption of the Uniform Act are as follows:

1. *Heightened pleading standards*: Plaintiffs must plead facts giving rise to a “strong inference” that the defendant acted with the required state of mind for fraud. In addition, if pleading on information and belief, plaintiffs are required to state all facts underlying those beliefs.<sup>235</sup>

2. *Stay of discovery*: Plaintiffs have no access to discovery while a motion to dismiss is pending. As a practical matter, the discovery stay ensures that every complaint will be met by a motion to dismiss and plaintiffs can no longer use discovery to frame an adequate complaint.<sup>236</sup>

3. *Safe harbor for forward-looking information*: Unrealized material forecasts are not subject to liability if the forecast was accompanied by meaningful cautionary language, or the forecast was not knowingly false when made.<sup>237</sup>

These reforms, directed largely at securities fraud class actions brought in federal court, left state securities fraud actions untouched.<sup>238</sup> Class action lawyers sought to avoid the restrictions imposed by the Reform Act by filing state law actions in state court. The migration to state court, (particularly in California) led companies (particularly high-technology firms located in Silicon Valley) to Washington seeking further legislation restricting such

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233. *See id.* at 1-2.

234. *See id.* at 2.

235. 15 U.S.C. § 78u-4(b)(1),(2) (Supp. IV 1998).

236. 15 U.S.C. § 780-4(b)(3)(B).

237. 15 U.S.C. § 78u-5.

238. *See* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 287 (1998) (“Congress seems to have viewed litigation reform as a federal problem that required a federal solution.”).



suits.<sup>239</sup> The shift of securities fraud litigation to state court, they argued, would undermine the effectiveness of the Reform Act.<sup>240</sup>

One answer to the problem of migration to state court would have been to impose the Reform Act's requirements on actions in state court. This wholesale intervention into state court procedures likely would have been held unconstitutional. While Congress clearly has the power to eliminate liability under state law for statements protected by the Reform Act's safe harbor, it is less clear that Congress would have the power to dictate when a state court judge must stay discovery in a state law cause of action, or to mandate the pleading standard that a judge should apply in assessing the sufficiency of a state law complaint. *Alden's* holding—that Congress cannot require state courts to do what it could not direct federal courts to do under Article III—might be read as implicitly authorizing the converse: Congress can impose requirements on state courts if it could impose similar requirements on federal courts. And Congress's power to impose procedural requirements on federal courts adjudicating state actions is unassailable. But this probably reads too much into *Alden's* reliance on Article III. The Court has stated on numerous occasions, albeit in dicta, that the federal government lacks the power to control state court procedures in adjudicating state law causes of action.<sup>241</sup> Imposing the Reform Act's stay of discovery and pleading standards on state courts adjudicating state law causes of action would clearly violate that principle, if that principle reflects a rule that binds Congress. The dilemma is created by the fact that the Court has never identified a constitutional basis for this principle.

The anti-commandeering rule may shed light on this question. Requiring a stay of discovery and heightened pleading standards would arguably fall within the scope of the anti-commandeering rule because state courts would be forced to regulate the litigation behavior of private parties at Congress's behest. Imposing such a requirement on state courts would go beyond the creation of federal rights and duties affecting primary conduct. If Congress wants to control securities fraud class actions, it can require that they be brought in federal court under federal law. Alternatively, the judicial exception to the anti-commandeering principle would allow Congress to preempt state fraud law entirely, but allow parties to bring their federal claims in state court. If Congress did this, the stay of discovery and

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239. See Leslie Eaton, *The Silicon Valley Gang; An Influential Industry With Lots of Money Is Getting Its Way on Capitol Hill*, N.Y. TIMES, June 11, 1998, at D1.

240. See Perino, *supra* note 238, at 315-18 (discussing implications of the rise in state securities class actions to the implementation of the Reform Act).

241. See *supra* notes 177-178 and accompanying text.

heightened pleading standards might be considered essential parts of the federal claim and thus appropriate for Congress to require that state courts follow these procedures in adjudicating the federal claim. The judicial exception to the anti-commandeering rule allows Congress to force state courts to enforce federal law because it is essential to protect the rights and obligations of individuals created by federal law. But it is difficult to characterize pleading standards and discovery, unaccompanied by a federal claim, as substantive rights or obligations. They are tools that courts use to manage litigation that determines substantive rights and obligations. Therefore, extending the Reform Act to state courts might have constituted a form of impermissible commandeering.

*B. Preemption of State Fraud Class Actions for Nationally-Traded Securities*

Rather than face these constitutional obstacles, Congress instead deprived state courts of the power to adjudicate certain securities fraud class actions. The Uniform Act preempts suits:

based upon the statutory or common law of a State or subdivision thereof . . . by any private party alleging—

- (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
- (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.<sup>242</sup>

The breadth of the preemption has an important limitation: it reaches only “covered securities.”<sup>243</sup> This definition relies on provisions added to the Securities Act by the National Securities Market Improvement Act (“NSMIA”).<sup>244</sup> The Securities Act preempts state registration requirements for “nationally traded securities,” which are defined as securities “listed, or authorized for listing, on the New York Stock Exchange (“NYSE”) or the American Stock Exchange (“AMEX”), or listed on the National Market

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242. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-352, § 101(a)(1), 112 Stat. 3227. While the language is not identical, the Uniform Act has essentially the same broad reach as the general federal anti-fraud prohibition found in the SEC’s Rule 10b-5 under the Exchange Act, the typical basis for federal class actions. See 17 C.F.R. § 240.10b-5 (1999).

243. Pub. L. No. 105-353, § 101(a)(1), 112 Stat. 3227.

244. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.)

System of the Nasdaq Stock Market” (“Nasdaq/NMS”) or “a security of the same issuer that is equal in seniority or that is a senior security” of the same issuer who has a security listed on the NYSE, AMEX, or Nasdaq\NMS.<sup>245</sup> The Uniform Act adds preemption of state anti-fraud class actions to NSMIA’s preemption of state registration requirements. Therefore, if the issuer has any securities listed on a national trading market, all of its securities equal or senior to that listed security are exempt from state anti-fraud class actions. Only issuers whose securities are not listed on national markets, primarily micro-cap and penny stock issuers, remain subject to state actions. This may be appropriate, as states have traditionally played an important role in combating fraud in these markets.<sup>246</sup> Thus, Congress is only preempting actions relating to securities that are being traded in interstate commerce.<sup>247</sup> Congress clearly has this power of preemption. The existence of national trading markets provides a sufficient nexus to interstate commerce,<sup>248</sup> and Congress has the authority to “prohibit all—and not just inconsistent—state regulation.”<sup>249</sup>

### C. Intrusions into State Court Procedures

The principal constitutional issue raised by the Uniform Act is the second limitation imposed on the scope of preemption. Preemption does not apply to all state fraud suits, but only to “class actions” raising fraud claims. The Uniform Act relies on a unique definition of “class action” that does not mirror the definition found in Federal Rule of Civil Procedure 23. Instead, the Act provides several overlapping definitions of actions involving multiple parties. “Class actions” are defined broadly to include:

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245. 15 U.S.C. § 77r(b)(1) (Supp. II 1996).

246. See Perino, *supra* note 238, at 331.

There is a strong case for maintaining state authority over causes of action involving smaller securities offerings, such as penny stock offerings, investment contracts, limited partnership programs, and blank-check offerings. These sorts of offerings often target unsophisticated investors and have been at the heart of many securities fraud scams. States have traditionally regulated these types of offerings and act as a sort of “cop on the beat” to help enforce antifraud rules.

*Id.* (citations omitted).

247. See *id.* at 321 (“[N]ational securities markets pay no heed to state boundaries: Whether buyers are located in New York, California, Montana, Connecticut, or elsewhere makes no difference to disclosure rules, price discovery mechanisms, or trading practices that govern transactions in national markets.”).

248. See, e.g., *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 258 (1964) (holding that courts must defer to a congressional finding that a regulated activity affects interstate commerce, if the finding has any rational basis).

249. *Hodel v. Virginia Surface Mining Ass’n, Inc.*, 452 U.S. 264, 290 (1981).

(i) any single lawsuit in which—

(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—

(I) damages are sought on behalf of more than 50 persons; and

(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.<sup>250</sup>

Subsection (ii) governs the typical securities fraud class action. It preempts cases where damages are sought by one or more named parties on behalf of themselves and as a representative of other unnamed parties.

The Uniform Act leaves an important set of fraud actions untouched. For example, if a broker or investment adviser defrauds thirty-five of her clients, that action could still be brought collectively under state law. And any individual who has been defrauded can bring an action under state law. Congress did not want to deprive individuals of their state law remedies when, for example, a small business owner sells overpriced stock in his company to his brother-in-law. Face-to-face transactions such as this are the bread and butter of state fraud law, and the only thing to be gained from a uniform federal standard is more work for federal courts. No interest group would be willing to pay for the federalization of such disputes.<sup>251</sup> Limiting

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250. Securities Act § 16(f)(2)(A) (codified at 15 U.S.C. § 77p(f)(2)(A) (Supp. IV 1998)).

251. See Macey, *supra* note 5, at 267 (“Congress will delegate to local regulators only when the political support it obtains from deferring to the states is greater than the political support it obtains from regulating itself.”). Indeed, Congress may pay a political price for complete preemption. See Hills, Jr., *supra* note 48, at 868.

With conditional preemption, Congress is constrained by its limited regulatory capacity. Congress cannot obtain the condition unless it can make a credible threat of preemption, but preemption is

preemption to class actions therefore reduces the intrusion into state regulatory authority in what would seem to be predominantly a state law concern, that of face-to-face transactions within one state.

Despite this concern for preserving state regulatory authority over primarily local transactions, limiting the Uniform Act's preemption to class actions raises a complicated constitutional question: can Congress dictate how state courts form adjudicate state law causes of action? The Court's decisions applying the Federal Arbitration Act to bar state courts adjudicating certain state law actions suggest that Congress can prevent state courts from deciding certain state law actions if there is a connection to interstate commerce.<sup>252</sup> But here Congress has restricted state court actions, based not on the substance of state law, but rather the procedure employed by the state court. This would seem to conflict with the Court's dicta stating that the federal government lacks the power to control state court procedures in adjudicating state law causes of action.<sup>253</sup> That dicta would suggest that the Uniform Act's prohibition of class actions is beyond Congress's authority.<sup>254</sup> But the Court has never stated the constitutional basis for this limitation on congressional power. Perhaps the Court assumed that control of state procedures was beyond Congress's Commerce Clause power when it first made these statements, and continues to repeat them now, despite its abandonment of any serious limits on Congress's enumerated powers. If so, the Court might abandon the rule when confronted with the question.<sup>255</sup>

The Court's constitutional federalism doctrine can help answer this question. The Uniform Act cannot be defended as a law of general applicability because state courts have an effective monopoly on the adjudication of these preempted claims. Private parties are not in the business of deciding state fraud class actions. Nor can it be defended on a conditional spending ground: Congress has not funded the states' court systems in exchange for fraud adjudication services.

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politically costly. Especially where federal regulators are inexperienced in some field, they might not be capable of replacing state law with equally popular federal laws. Federal inexperience might turn any federally implemented regulatory scheme into a political liability for Congress.

*Id.*

252. See *supra* notes 187-189 and accompanying text.

253. See *supra* notes 177-178 and accompanying text.

254. Congress would have the authority to prevent violations of the Due Process Clause under the Fourteenth Amendment, but it is difficult to see the class action device as a due process violation. See Parnet, *supra* note 14, at 30 ("[B]ecause there is no Fourteenth Amendment right to a prohibition of joined claims, class actions or consolidated actions, it would be difficult to justify [preclusion of class actions] as authorized by Section 5 of the Fourteenth Amendment.").

255. But see Joan Steinman, *Reverse Removal*, 78 IOWA L. REV. 1029, 1083 (1993) (questioning whether litigation in state court can be deemed "commerce").

On the other hand, eliminating state court class actions does not fit neatly in the commandeering category. Following the *New York* and *Printz* analyses, Congress has not directed the state courts to regulate anyone; it has simply barred state courts from regulating in a certain way. In this sense, the Uniform Act looks like simple preemption. Alternatively, the Uniform Act could be thought of as a form of conditional preemption. If the states choose to regulate securities fraud, they must do so in a certain way, through individual actions. On this view, straightforward application of *FERC* justifies the intrusion into state court procedures as falling within Congress's Commerce Clause authority and not running afoul of the commandeering rule. As Justice Harlan put it:

The right of the State to regulate its own procedures governing the conduct of litigants in its courts, and its interest in supervision of those procedures, stand on the same constitutional plane as its right and interest in framing 'substantive' laws governing other aspects of the conduct of those within its borders.<sup>256</sup>

Therefore, if procedure "stands on the same constitutional plane" as substantive law, Congress can apply its power of conditional preemption to state courts.

Nor would the *Alden* version of commandeering, allowing a private party to use a state entity against the state, be implicated by the Act.<sup>257</sup> State courts are hearing disputes only between private parties, and Congress is not even forcing the courts to do that. Moreover, Congress has provided an alternative regulatory scheme in the federal securities laws with a range of compensatory remedies if states choose not to regulate, so it is difficult to see any element of coercion.

This analysis is consistent with the normative justification underlying the Court's constitutional federalism decisions identified by this Article.<sup>258</sup> The form of preemption chosen by Congress is liberty enhancing. The Uniform Act eliminates a portion of state regulation that threatens to interfere with the federal regulatory scheme. It therefore leaves individuals with only one set of regulations with which they must comply, rather than two.<sup>259</sup> It also preempts

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256. *Fay*, 372 U.S. at 466-67 (Harlan, J., dissenting).

257. See *supra* notes 212-220 and accompanying text.

258. See *supra* notes 78-104 and accompanying text.

259. Elimination of duplicative regulation is the traditional justification offered by proponents of securities law preemption. See, e.g., Mark A. Sargent, *A Future for Blue Sky Law*, 62 U. CIN. L. REV. 471, 494 (1993) ("From the securities industry's perspective, blue sky law has offered only duplicative, nonuniform regulation and endless demands for paper and fees."); Brian J. Fahrney, Comment, *State Blue Sky Laws: A Stronger Case for Federal Pre-Emption Due to Increasing*

an area of state law that corporate issuers cannot easily evade by their choice of state of incorporation.<sup>260</sup> And because of the risk that states will try to extract rents from foreign corporations through lax liability standards, efficiency is arguably enhanced as well.<sup>261</sup> Congress has narrowed state regulatory authority in an area where federal authority is unquestioned. Unfortunately for state politicians, this wide discretion given to Congress in preempting state legislation means that non-preempted areas most likely will be ones in which there are few rents to extract or administrative burdens are likely to be great, e.g., adjudicating hundreds of ordinary business disputes as securities fraud actions. Notwithstanding this curtailment of state regulatory authority, the “constrained libertarianism” theory of constitutional federalism cases supports the constitutionality of the Uniform Act.

#### *D. The Discovery Stay*

Preempting class actions, but not individual actions, creates an obvious loophole around the Reform Act’s discovery stay provision. Plaintiffs’ lawyers would still be free to bring a federal class action and a parallel state action on behalf of an individual who would otherwise be a member of the class. Discovery obtained in the individual action could then be used to bolster the complaint in the class action.

In seeking a more effective solution to the discovery stay problem, a conundrum arises. The obvious solution would be to preempt *all* securities

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*Internationalization of Securities Markets*, 86 NW. U. L. REV. 753, 757-58 (1992) (“In many cases, the state and federal regulatory bodies impose overlapping requirements, causing needless, wasteful duplication for issuers.”).

260. See Perino, *supra* note 238, at 325.

The structure of the securities fraud market essentially precludes mobility for publicly held companies whose securities trade on national markets. Unlike the corporate charter market, the securities fraud market has nothing equivalent to the corporate internal affairs doctrine, which preserves mobility by giving corporations the ability to opt in to one state’s regulatory scheme simply by reincorporating there.

*Id.*

261. See Michael G. Dailey, Comment, *Preemption of State Court Class Action Claims for Securities Fraud: Should Federal Law Trump?*, 67 U. CIN. L. REV. 587, 606 (1999) (discussing availability of negligent misrepresentation claim under state law); Perino, *supra* note 238, at 327.

Negative spillover effects can be a significant problem in the market for securities fraud causes of action because most shareholders of a given publicly traded company will not reside in the jurisdiction. In-state plaintiffs will benefit from more lax liability rules while the costs of such rules, e.g., a higher cost of capital, are largely exported out-of-state. Under these conditions, states have incentives to create plaintiff-favorable laws that may permit excessive securities litigation, one of Congress’ primary concerns when it enacted the Reform Act.

*Id.*

actions, not just class actions.<sup>262</sup> Such a course would have removed all constitutional difficulties, as Congress clearly has the power to exclude states from regulating the national securities markets. As discussed above, however, preempting all state securities actions comes at a cost. Investors defrauded in local transactions would be precluded from suing in state court under state law, even though the state interest would likely outweigh the federal interest in such cases. Thus, complete preemption would have posed a substantial threat to state regulatory authority, as well as imposing a substantial burden on federal courts. In any event, even preemption of all actions probably would not have stopped circumvention of the federal discovery stay. Plaintiffs would still be left with certain options, including state court derivative actions and state inspection statutes, unless Congress preempted corporate law as well.<sup>263</sup>

Rather than preempt all state fraud actions, Congress gave federal courts control over discovery in the remaining securities cases that Congress has not reserved to the federal courts. The Uniform Act provides:

#### Circumvention of stay of discovery

Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.<sup>264</sup>

Congress's preservation of the states' regulatory authority over some cases required an alternative incursion into the state courts' control over their dockets. As written, the stay gives federal judges broad discretion in staying state discovery; it literally applies to "any private action" of any description. The language "as necessary in aid of its jurisdiction, or to protect or effectuate its judgments" tracks that found in the Anti-Injunction Act,<sup>265</sup> courts are likely to look there for guidance. If they do, they should be unlikely to enjoin state discovery based on an anticipated, but unfiled federal action.<sup>266</sup> The language of the provision reinforces the conclusion that a

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262. The first bill introduced would have preempted all private state anti-fraud actions, but it quickly fell by the wayside. See H.R. 1653, 105th Cong. (1997).

263. See Randall S. Thomas and Kenneth J. Martin, *Using State Inspection Statutes for Discovery in Federal Securities Fraud Actions*, 77 B.U. L. REV. 69, 84 (1997).

264. 15 U.S.C. § 77z-1(b)(4) (Supp. IV 1998).

265. See 28 U.S.C. § 2283 (1994) ("A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments").

266. See *Carlough v. Amchem Prods., Inc.*, 10 F.3d 189, 201 (3d Cir. 1993) (holding that "the district court was obliged to ascertain, at least in a preliminary fashion, its own subject matter



federal action must already be filed, as it is limited to “an action subject to a stay of discovery.”<sup>267</sup> Allowing the federal courts to enjoin state court proceedings when no federal action had been filed would raise serious constitutional issues.<sup>268</sup> If the discovery stay provision is interpreted consistently with the Anti-Injunction Act, it is unlikely to provoke constitutional difficulties. The interference with state court procedures would be limited to what was needed to ensure that federal court litigation proceeded as Congress intended, a straightforward application of the Supremacy Clause.

### *E. Removal to Federal Court*

One more provision of the Uniform Act interferes with state court adjudication of fraud actions. Subsection (c) allows the defendant to remove covered class actions to federal court.<sup>269</sup> The provision is unusual, in that it allows actions to be removed to federal court even though they are preempted by the Uniform Act. That is, it allows for removal of actions so that they can be dismissed in federal court. Ordinarily, one would expect the law to require the defendant to bring its motion to dismiss or demurrer in state court. Indeed, the Uniform Act appears to strip the state court of subject matter jurisdiction and the court should therefore dismiss the case on its own motion.

The removal provision, however, serves two important federal interests: (1) it allows federal courts to interpret the scope of preemption, thus enhancing uniformity; and (2) it triggers the Reform Act’s stay of discovery. Some state court rules allow discovery while a motion to dismiss is pending, thus forcing the defendant to seek a discretionary stay from the state court, or an injunction against discovery from a federal court under the Uniform

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jurisdiction . . . before issuing an injunction in aid of that jurisdiction.”).

267. The first case to construe this provision inexplicably declined to apply it to an individual state court securities action. *In re Transcript Int’l Sec. Litig.*, 57 F.Supp.2d 836 (D. Neb. 1999). This decision is inconsistent with the text of the statute (“any private action”) and negates the primary purpose of the provision.

268. See *Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Engr’s*, 398 U.S. 281, 287 (1970) (stating that the Anti-Injunction Act’s “statutory prohibition against such injunctions in part rests on the fundamental constitutional independence of the States and their courts”). Resolving the question on statutory grounds, the Court had no occasion to specify what limits that “fundamental constitutional independence” placed on Congress. *Id.*

269. 15 U.S.C. § 77p(c) (Supp. IV 1998) (“Any covered class action brought in any State court involving a covered security, as set forth in subsection (b) of this section, shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b) of this section.”).

Act.<sup>270</sup> Removal allows the defendant to file a motion to dismiss based on the Uniform Act in federal court. The motion to dismiss automatically triggers the federal discovery stay under the Reform Act.<sup>271</sup> Thus, removal allows Congress to protect issuers against the costs of “fishing expedition” discovery without further interference with state courts.

The removal provision does not raise any substantial constitutional difficulties. The Uniform Act creates a federal defense to a state law cause of action, and the removal provision allows a federal court to hear that federal question. This practice is well established.<sup>272</sup>

#### *F. Limits on the Scope of Preemption*

The remaining provisions of the Uniform Act raise no constitutional federalism issues, but they do show that Congress took into account the balance between the federal and state governments in drafting the law. The preemption of the Uniform Act is limited in important ways that protect state regulatory authority and financial interests.

##### *1. Protection of State Corporate Law*

The original bills that eventually became the Uniform Act would have had the unintended effect of preempting a substantial body of state corporate law. The Supreme Court has zealously guarded the distinction between state corporate law and federal securities law,<sup>273</sup> while Congress and the SEC have generally respected this distinction. In addition, the internal affairs doctrine ensures that a corporation will not face diverse state regulation, and more importantly, that the regulation will be no more intrusive than the managers

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270. The injunction against discovery may or may not be available, depending on whether a parallel action has been filed.

271. If a non-preempted action has been removed erroneously to federal court, subsection (d)(4) allows the federal court to remand the action to state court. 15 U.S.C. § 77p(d)(4).

272. See *Tennessee v. Davis*, 100 U.S. 257, 264 (1879).

A case consists of the right of one party as well as the other, and may truly be said to arise under the Constitution or a law or a treaty of the United States whenever its correct decision depends upon the construction of either. Cases arising under the laws of the United States are such as grow out of the legislation of Congress, whether they constitute the right or privilege, or claim or protection, or defence [sic] of the party, in whole or in part, by whom they are asserted. “When a question to which the judicial power of the Union is extended by the Constitution forms an ingredient of the original cause, it is in the power of Congress to give the circuit courts jurisdiction of that cause, although other questions of fact or of law may be involved in it.”

*Id.* (quoting *Osborn v. The Bank of the United States*, 22 U.S. (9 Wheat.) 738, 823 (1824)).

273. See *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (“[W]e are reluctant to federalize the substantial portion of the law of corporations that deals with transacting in securities, particularly where established state policies of corporate regulation would be overridden.”).

of the corporation think appropriate. Because managers and shareholders can choose which state corporate law will apply for the company, by choosing the state of incorporation, substantial freedom of contract is ensured.

In order to preserve the role of state corporate law, the overall definition of class action was revised to explicitly exclude "an exclusively derivative action brought by one or more shareholders on behalf of a corporation."<sup>274</sup> Derivative actions, of course, are the only enforcement vehicle available for fiduciary duties owed to the corporation, essential to corporate governance, and traditionally the province of state courts.

Other corporate law duties, however, required a more carefully tailored carve out. Under state corporate law, issuers and their officers and directors generally owe a fiduciary duty of disclosure to their shareholders.<sup>275</sup> That duty of disclosure requires the issuer and its managers to speak truthfully to its shareholders.<sup>276</sup> Even though the corporate law duty of disclosure significantly overlaps with the coverage of federal securities law, actions based on corporate duty of disclosure are generally interwoven with other corporate law claims. Claims based on the breach of this duty typically arise out of mergers, tender offers and other extraordinary corporate transactions, when the board is asking shareholders to take certain actions. These claims are individual, rather than derivative, because they affect the shareholder's decision involving his individual shares, even though it may have an effect on the corporation as a whole. These claims are routinely litigated in state courts, most notably the Delaware Chancery Court. The Chancery Court has developed expertise in this area that the federal courts are unlikely to match. In addition, the Delaware courts can resolve these claims within days rather than months, an important consideration if a merger is pending.

A limitation, tagged the "Delaware carve out," was adopted in order to preserve these advantages of state law. This effort had widespread support, including that of corporate issuers, who were interested in maintaining the predictability offered by Delaware corporate law.<sup>277</sup> The carve out contains two prongs. Subsection (i) preserves state jurisdiction for breach of fiduciary duty claims arising from transactions taking place between the issuer and its security holders, while subsection (ii) preserves state jurisdiction for breach

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274. 15 U.S.C. § 77p(f)(2)(B) (Supp. IV 1998).

275. See *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998). See generally Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087 (1996); Nicole M. Kim, Note, *Malone v. Brincat: The Fiduciary Disclosure Duty of Corporate Directors Under Delaware Law*, 74 WASH. L. REV. 1151 (1999).

276. See *id.*

277. See Rachel Witmer, *SEC, Private Bar Working to Address Flaw in Litigation Reform Bills*, 30 SEC. REG. & L. REP. (BNA) 169, 170 (Jan. 30, 1998).

of fiduciary duty claims arising from an issuer's recommendation, position, or other communication concerning mergers and other extraordinary corporate transactions.<sup>278</sup> The carve out is limited to actions "based upon the statutory or common law of the State in which the issuer is incorporated . . . or organized."<sup>279</sup> This limitation gives the issuer control over its litigation exposure because it can choose its state of incorporation. It is therefore consistent both with maintaining state regulatory authority and the freedom of managers and shareholders to choose their regulatory regime. And whatever one thinks of the balance that state corporate law strikes between managers and shareholders, federalizing this area of law is unlikely to improve the situation for shareholders.<sup>280</sup>

## 2. Protecting State Financial Interests

In addition to preserving state regulatory authority, Congress protected state financial interests with the final limitation on the scope of preemption. The preemption of state class actions is a law of general applicability that can be imposed on the states as well as individuals. Nonetheless, a separate carve out was made for state governments and pension funds to use state law to

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278. See 15 U.S.C. § 77p(d)(1). The Delaware carve out creates at least one unavoidable problem: it re-opens the "reverse auction" for class action settlements. The "reverse auction" problem was created by the Supreme Court's decision in *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996). In that case, the Supreme Court held that a state court class action settlement, which released both state law claims and federal securities claims pending in a parallel federal suit, had a preclusive effect on the federal claims. The state court judgment precluded the federal claims notwithstanding the federal court's exclusive jurisdiction over the federal securities claims under Section 27 of the Exchange Act. *Matsushita* raises the possibility that defendants will be able to minimize their liability exposure through a "reverse auction," offering to settle claims against them with the plaintiffs' attorney who offers the lowest bid. See generally John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1370-72 (1995). This result obviously threatens the interests of the plaintiff class, which could have its claims sold out on the cheap.

The Uniform Act reduces the potential for a "reverse auction." By eliminating parallel state securities class actions, the Uniform Act lessens the chances for a collusive settlement between defendants and a faithless plaintiffs' attorney. However, the Uniform Act does not eliminate the potential for a "reverse action." The result of the Delaware carve out, and the exclusion for derivative claims, is that there will still be some parallel state actions where federal securities claims can be settled, even though they cannot be litigated on the merits in state court because of exclusive federal jurisdiction. Thus, the *Matsushita* reverse auction problem persists in that category of cases. Defendants will still be able to run "reverse auctions" when state cases have been filed, pitting state court plaintiffs against federal court plaintiffs. This may explain the willingness of corporate issuers to preserve state corporate law claims. Allowing corporate law claims may reduce the settlement value of securities law claims. In this case, more may be less; more potential fora could lead to less liability exposure.

279. 15 U.S.C. § 77p(d)(1)(A) (Supp. IV 1998).

280. The effect of state competition to provide corporate charters has been disputed. See *supra* note 85.

protect their own financial interests. Under this carve out, state entities are allowed to bring class actions under state law.<sup>281</sup> The provision saves actions by state entities from the grouping provision in the definition of class action. Even without this provision, state entities were free to sue in state court where they would only count as one investor for purposes of the preemption threshold. With the amendment, state entities may not be grouped with any other plaintiff (state entity or not) for purposes of counting to fifty. In practice, the amendment is unlikely to be invoked with any frequency, as most state entities will find it cheaper to participate in a broader-based federal class action. Only when state law confers substantial advantages will it make sense for state entities to bear the expense of bringing their own class action. Notwithstanding the unlikelihood of this provision being invoked, it does demonstrate Congress's concern that the states have the means to protect their financial integrity. The provision is evidence supporting the claim of the *Garcia* court that the states were capable of securing exemptions from laws of general applicability in Congress.

### CONCLUSION

The Court's recent constitutional federalism decisions place some modest constraints on the growth of federal power. I have argued in this article that those constraints encourage states to serve as focal points against federal incursions into individual liberty. Applying this analysis to the Uniform Act suggests that the Act does not run afoul of principles of constitutional federalism.

Some may view the promotion of individual liberty to be misguided.<sup>282</sup> Others may view these constraints as being so modest as to be trivial.<sup>283</sup> It is

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281. The Uniform Act provides that:

Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

15 U.S.C. § 77p(d)(2)(A) (Supp. IV 1998).

282. See Bednar & Eskridge, Jr., *supra* note 110, at 1490 ("Overall, the Court's recent decisions have a decidedly libertarian slant reminiscent of the *Lochner*-era bias that was repudiated by the New Deal."); Chemerinsky, *supra* note 108, at 501 ("Hindsight reveals that federalism has been primarily a conservative argument used to resist progressive federal efforts, especially in the areas of civil rights and social welfare."); Adler & Kreimer, *supra* note 141 (criticizing the Court's distinction between preemption and commandeering: "We doubt that state action, at least state action within this zone, is more likely to produce significant harm to the interests or welfare of the citizenry, or of some portion thereof, than state action.").

283. See, e.g., Cross, *supra* note 169, at 1304 (arguing that "federalism does not now and will

too soon to assess the efficacy of the Court's revived constitutional federalism doctrine in promoting liberty. The states have, on occasion, served as bulwarks against federal overreaching.<sup>284</sup> If the point of the new constitutional federalism is to harness the states as allies of individual liberty, its effectiveness can only be assessed over time as regulatory battles are fought out in Congress. But it does seem fair to say that the new constitutional federalism is unlikely to bring about a wholesale revision of the welfare state brought by the New Deal.<sup>285</sup>

For a revival of restraint on the federal government, we are likely to see more progress from competition than from the Constitution. International trade and global capital markets impose a far more substantial discipline on Congress than does the Supreme Court.<sup>286</sup> This new order of world-wide free trade holds the promise of recreating the freedom-protecting competition that the United States enjoyed under its original "dual sovereignty" version of federalism.<sup>287</sup> If individuals and businesses have a choice among jurisdictions when making an investment, jurisdictions have a powerful incentive to make themselves attractive to such investment.<sup>288</sup> Government fears this trend, of

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never have authentic legal significance as a principled constraint on the power of the national government."); Caminker, *supra* note 88, at 1088.

Just beneath the surface of the Court's opinions in *New York, Gregory*, and other recent federalism cases, lurks a discernible and genuine lament about the tremendous expansion of congressional power since the Constitution's Founding, coupled with an apparent frustration over what to do about it. The Court's anti-commandeering rule appears borne of this frustration, best understood as a symbolic gesture—waving the banner of state sovereignty whether victory was here deserved or not.

*Id.*

284. See SHAPIRO, *supra* note 85 (citing the role of states in opposing the Alien and Sedition Acts and the Fugitive Slave Laws and as early champions of individual rights). But see *id.* at 52 ("[T]he states do not appear to have served as a bulwark of individual and group rights and interests."). See also Friedman, *supra* note 26, at 403 ("It was the states first called for balanced budgets and fiscal responsibility, and many recent state government decisions afford greater liberty to citizens than they receive under the federal constitution.").

285. See Cross, *supra* note 169, at 1325 ("Doctrines such as the plain statement rule and the anticommandeering principle are probably the farthest the Court will go in defending federalism."); Powell, *supra* note 102, at 670 (arguing that "the social reality that virtually all political groups and persuasions want broad national powers wielded on behalf of their desired objectives" makes it "unlikely that the Court could defy for very long the practical consensus that federal powers should be indefinitely broad even if the Justices wished to do so.").

286. See David Wessel, *The Long Run Arrives Early*, WALL ST. J., Aug. 2, 1999, at A1 (discussing increasing speed with which capital markets act in rewarding "market-friendly economic policies" and sanctioning "wrong-headed economic policies").

287. See generally Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1 (1995).

288. See McGinnis, *supra* note 21, at 593 ("Global opportunities for trade and investment inhibit the federal government's natural tendency toward the expropriation of wealth. If individuals may choose where to invest and companies may choose where to produce, they gain leverage against the power of the government."). See also Rodden & Rose-Ackerman, *supra* note 85, at 1530 n.45 (citing

course, so we can expect attempts to create new levels of government with ever-widening jurisdiction.<sup>289</sup> These attempts will put pressure on state regulation, as efforts to “harmonize” regulation on an international basis may be incompatible with the lack of uniformity inherent in a federal system.<sup>290</sup> The collective action problems that governments face in reaching an international consensus are perhaps the best hope for liberty.

If this analysis is correct, federalism at the national level may come to have a distinctly secondary role as a structural influence on the creation of public policy, despite the best efforts of the Supreme Court.<sup>291</sup> It is possible, however, that the constrained libertarianism version of constitutional federalism may limit the growth of government power and give the United States a comparative advantage in the international competition for capital.

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literature on advantages of inter-jurisdictional competition).

289. See Barry Friedman, *Federalism's Future in the Global Village*, 47 VAND. L. REV. 1441, 1444 (1994).

Accompanying this internationalization of commerce is a similar process regarding regulatory authority. Just as recent years have witnessed the tumbling of international boundaries and blockades, there also has been significant growth in both the number of international agreements that tie the world together, and the activity of international organizations acting under those agreements.

*Id.*

290. See *id.* at 1448-50 (discussing pressure of internationalization on state securities laws).

291. See SHAPIRO, *supra* note 85, at 38 (“[A]t least with respect to capital and to an increasing extent with respect to productive and needed workers, the ability to move across international borders may be growing to the point that the importance of the right to reject the policies of a particular state by moving to another state is a diminishing one. . . . [T]he international mobility of goods, capital, and labor is reducing the economic significance of interstate mobility as a means of escaping the restrictive or unpopular rules of a particular state.”).